

**REPORT OF
INVESTIGATION OF ALLEGATIONS
RELATING TO INTERNAL REVENUE SERVICE HANDLING
OF TAX-EXEMPT ORGANIZATION MATTERS**

Prepared at the Request of
Chairman William V. Roth, Jr.,
Vice Chairman Bill Archer,
Senator Daniel Patrick Moynihan, and
Congressman Charles B. Rangel

By
The Staff of
The Joint Committee on Taxation



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JOINT COMMITTEE ON TAXATION

106th CONGRESS, 2nd SESSION

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INTRODUCTION

Beginning in 1996, certain news media reports alleged bias in the handling of tax-exempt organization matters by the Internal Revenue Service (“IRS”). A list of some of the articles addressing issues relating to the IRS’s handling of tax-exempt organizations is included in Exhibit 1-1.

On February 25, 1997, then-IRS Commissioner Margaret Milner Richardson wrote to Chairman Bill Archer of the House Committee on Ways and Means (“Ways and Means Committee”) and Chairman William V. Roth, Jr., of the Senate Committee on Finance (“Finance Committee”).¹ In her letter, Commissioner Richardson noted that recent media reports had alleged politically targeted examinations of tax-exempt organizations by the IRS. Commissioner Richardson requested the opportunity to provide to the Ways and Means Committee and the Finance Committee information relating to these allegations, as authorized under section 6103(f)² of the Internal Revenue Code (“the Code”). In addition, Commissioner Richardson requested the opportunity to explore with Chairman Archer and Chairman Roth the possibility of using Code section 6103(k)(3)³ to permit the IRS to correct misstatements of fact regarding examinations of tax-exempt organizations.

On March 24, 1997, Chairman Bill Archer, Vice Chairman William V. Roth, Jr., Senator Daniel Patrick Moynihan and Congressman Charles B. Rangel of the Joint Committee on Taxation (“Joint Committee”) sent a letter to then-Joint Committee Chief of Staff Kenneth J. Kies.⁴ In that letter, the Chairman, Vice Chairman, Senator Moynihan, and Mr. Rangel (“the Members”) indicated their concern about recent reports alleging politically motivated treatment of certain tax-exempt organizations and individuals by the IRS. Pursuant to section 8022 of the Code,⁵ the Members directed the staff of the Joint Committee (“Joint Committee staff”) to

¹ A copy of Commissioner Richardson’s letter is included as Exhibit 1-2.

² Code section 6103(f) authorizes the disclosure of confidential taxpayer return information to committees of Congress and the Chief of Staff of the Joint Committee on Taxation.

³ Code section 6103(k)(3) authorizes the Secretary of the Treasury, subject to the approval of the Joint Committee on Taxation, to disclose information relating to a specific taxpayer to the extent necessary for tax administration purposes to correct a misstatement of fact published or disclosed with respect to the taxpayer’s return or any transaction of the taxpayer with the IRS.

⁴ A copy of this letter is included as Exhibit 1-3.

⁵ Code sec. 8022 requires the Joint Committee, among other things, to investigate the administration of the Federal system of taxes by the IRS.

investigate whether the IRS's selection of tax-exempt organizations (and individuals associated with such tax-exempt organizations) for audit had been politically motivated. The investigation was to include an analysis of the selection of such tax-exempt organizations for audit for reasons related to their alleged political or lobbying activities. According to the Members, the scope of the investigation was limited to tax-exempt organizations described in Code sections 501(c)(3) and 501(c)(4) and individuals associated with such tax-exempt organizations. Because allegations were also made concerning IRS handling of determination letter applications, a review of these IRS processes was included within the scope of the Joint Committee staff investigation.

Prior to commencement of the Joint Committee staff investigation, the then-IRS Office of Inspection began an investigation of the same allegations in response to a referral made by then-Assistant Commissioner of Employee Plans and Exempt Organizations Evelyn Petschek.⁶ When the IRS Office of Inspection began its investigation, the then-Treasury Inspector General commenced a parallel investigation. Where applicable, this report references the findings and recommendations of the IRS Office of Inspection and the Treasury Inspector General. In addition, the Treasury Inspector General for Tax Administration ("TIGTA") provided reports to the Joint Committee staff on certain investigations conducted in response to referrals with respect to organizations or individuals within the scope of the Joint Committee staff investigation.

This Report,⁷ prepared by the Joint Committee staff, presents the following information: an Executive Summary (Part I); a summary of the allegations made (Part II); the Joint Committee staff findings (Part III); a description of the methodology and scope of the Joint Committee staff investigation (Part IV); and a detailed description of the critical elements of the Joint Committee staff investigation, including current IRS practices with respect to determination letters and examinations, IRS handling of information items, and employee conduct practices and procedures (Part V). Three exhibits are included: a list of articles relating to IRS handling of tax-exempt organization matters (Exhibit 1-1), a letter from IRS Commissioner Margaret Milner Richardson (Exhibit 1-2), and the letter directing the Joint Committee staff investigation (Exhibit 1-3). In addition, this Report contains two Appendices: Appendix A contains an overview of

⁶ When the Joint Committee staff investigation began, both the IRS Office of Inspection and the Treasury Inspector General had oversight and investigative responsibilities with respect to allegations relating to the IRS and IRS employees. The IRS Restructuring and Reform Act of 1998 ("IRS Reform Act") eliminated the IRS Office of Inspection and transferred all powers and responsibilities of that office to a new Treasury Inspector General for Tax Administration. In addition, the IRS Reform Act redefined the role of the existing Treasury Inspector General to exclude responsibility for the IRS. References in this document to the IRS Office of Inspection and the Treasury Inspector General are to those offices as in effect prior to the IRS Reform Act.

⁷ This Report may be cited as follows: Joint Committee on Taxation, *Report of Investigation of Allegations Relating to Internal Revenue Service Handling of Tax-Exempt Organization Matters* (JCS-3-00), March 2000.

tax-exempt organizations and a description of the IRS Office of Employee Plans and Exempt Organizations⁸ and Appendix B describes the present-law Federal tax rules applicable to the lobbying and political activities of tax-exempt organizations.

⁸ Pursuant to IRS Commissioner Rossotti's reorganization plan for the IRS, the IRS Office of Employee Plans and Exempt Organizations is being restructured into the Tax Exempt and Government Entities Operating Division. Because the applicable IRS organization during the course of the Joint Committee staff investigation was the IRS Office of Employee Plans and Exempt Organizations, this document does not discuss the Tax Exempt and Government Entities Operating Division.

I. EXECUTIVE SUMMARY

Summary of allegations made concerning IRS handling of exempt organization matters

Beginning in 1996, allegations appeared in various media reports that the IRS was engaged in politically targeted examinations of tax-exempt organizations. Additional allegations were made in submissions to, and by individuals interviewed by, the Joint Committee staff in connection with its investigation.

Some allegations related to IRS actions with respect to political and lobbying activities of specific tax-exempt organizations. Other allegations related to more general targeting by the IRS of organizations with views opposed to the Clinton Administration. These allegations can be summarized as follows:

- the IRS handling of determination letter requests for organizations perceived to represent political views that were opposed to the Clinton Administration was biased;
- the IRS inappropriately granted determination letters or expedited the granting of determination letters for organizations whose views were in line with those of the Clinton Administration;
- the IRS handling of examinations of tax-exempt organizations (and individuals associated with such organizations) that were opposed to or were critical of the Clinton Administration's policies was biased;
- the IRS did not conduct examinations of organizations favored by the Clinton Administration engaged in activities similar to other tax-exempt organizations that were under examination;
- the IRS inappropriately initiated examinations of certain tax-exempt organizations in response to information provided to the IRS by the White House or other influential individuals (e.g., Members of Congress) whose views aligned with the Clinton Administration and in opposition to the organizations targeted; and
- IRS employees assigned to cases of tax-exempt organizations whose views were in opposition to the Clinton Administration exhibited bias in their handling of such cases.

Joint Committee staff investigation in general

The Joint Committee staff investigation focused on a review of (1) how the IRS generally administered the law relating to the political and lobbying activities of tax-exempt organizations, (2) how the IRS generally administered determination letter requests of tax-exempt organizations, (3) how the IRS generally selected tax-exempt organizations for examination, and

(4) the IRS handling of matters relating to certain specific tax-exempt organizations and individuals associated with such tax-exempt organizations.

Joint Committee staff review of IRS handling of specific tax-exempt organizations and individuals

The Joint Committee staff identified 142 tax-exempt organizations (and individuals related to such organizations) that were potentially within the scope of the Joint Committee investigation through the following sources: (1) media reports, (2) contacts from tax-exempt organizations and individuals, (3) information provided by the IRS (including the IRS Office of Inspection) and the Treasury Inspector General, and (4) information received from the Senate Governmental Affairs Committee. From these sources, the Joint Committee staff identified more than 130 organizations and individuals potentially within the scope of the investigation. The Joint Committee staff received briefings and/or summary materials prepared by IRS National Office personnel relating to each of these organizations or individuals. The Joint Committee staff identified 83 organizations and individuals for which complete case file reviews were conducted to evaluate IRS conduct with respect to the taxpayers.

The Joint Committee staff reviewed hundreds of boxes of case file material supplied by the IRS with respect to the organizations and individuals identified as within the scope of the Joint Committee staff investigation. In addition, the Joint Committee staff conducted in-depth interviews of 57 current and former IRS employees, many of whom were directly or indirectly involved in the cases of the organizations and individuals within the scope of the Joint Committee staff investigation. Follow-up interviews were conducted with a number of IRS employees to clarify inconsistencies in statements or to pursue additional information relating to the cases in question. The Joint Committee staff reviewed personnel files of IRS employees in certain circumstances.

The Joint Committee staff contacted organizations and individuals whose names had appeared in media reports and invited the organizations to meet with Joint Committee staff or to submit written responses to questions. The Joint Committee staff met with representatives of ten organizations or individuals and received written submissions from a number of other organizations.

Joint Committee staff review of other materials

In addition to the review of specific case file information with respect to organizations and individuals within the scope of the Joint Committee staff investigation, the Joint Committee staff reviewed extensive other information relating to IRS handling of tax-exempt organization matters in general and other information that may be relevant to the cases within the scope of the investigation. The Joint Committee staff review included the following information: (1) all determination letter and examination data for tax-exempt organizations from 1990 through 1998, (2) all Congressional correspondence to the IRS from 1995 through 1997, (3) IRS management

information and reports from 1990-1997, (4) IRS correspondence and case tracking systems, (5) Internal Revenue Manual procedures, (6) policies and procedures of the IRS, the Treasury Department, and the White House with respect to conduct of employees and employee involvement in specific taxpayer matters, (7) all allegations of employee misconduct with respect to tax-exempt organization matters from 1990-1998, and (8) information supplied by the Justice Department, the Treasury Department, and the White House.

Summary of Joint Committee staff findings

Most of the information supplied by the IRS to the Joint Committee staff in the course of its investigation constitutes taxpayer return information that cannot be disclosed pursuant to section 6103 of the Internal Revenue Code.⁹ Thus, the Joint Committee staff findings do not include any specific findings of the Joint Committee staff with respect to the organizations and individuals within the scope of the Joint Committee staff investigation or any information that might identify such organizations or individuals. These findings represent the general conclusions drawn by the Joint Committee staff from its extensive review of IRS case file information, other information received from the IRS, other Federal agencies, and other sources, and interviews with relevant Federal employees and others.

IRS handling of tax-exempt organization determination letter requests

- The Joint Committee staff found no credible evidence that the IRS delayed or accelerated issuance of determination letters to tax-exempt organizations based on the nature of the organization's perceived views.
- The Joint Committee staff found that determination letter applications forwarded to the IRS National Office for handling took much longer on average for the IRS to process. The Joint Committee staff found no credible evidence that the forwarding of certain determination letter applications to the IRS National Office was the result of a deliberate effort by IRS employees to subject organizations with views that opposed the Clinton Administration to more intense scrutiny. The Joint Committee staff found that the delay by the IRS National Office in processing the determination letter application of one organization was unacceptably slow, but the Joint Committee staff found no credible evidence either of bias by IRS employees or other political intervention causing the delay.

⁹ Under section 6103(f)(4), the Chief of Staff of the Joint Committee may receive taxpayer return information from the IRS. However, such Chief of Staff may not disclose any taxpayer return information received. Unauthorized disclosure of tax return information protected under section 6103 is a felony punishable by a fine of up to \$5,000, imprisonment for up to five years, or both.

IRS handling of tax-exempt organization examinations

- The Joint Committee staff found no credible evidence that tax-exempt organizations were selected for examination, or that the IRS altered the manner in which examinations of tax-exempt organizations were conducted, based on the views espoused by the organizations or individuals related to the organization.
- The Joint Committee staff found no credible evidence of intervention by Clinton Administration officials (including Treasury Department and White House officials) in the selection of (or the failure to select) tax-exempt organizations for examination.
- The Joint Committee staff found that certain cases involving high-profile tax-exempt organizations and individuals received intense internal review and scrutiny by the IRS; however, the Joint Committee staff found no credible evidence that such increased review or scrutiny was politically motivated.
- The Joint Committee staff found that the interaction between the Office of IRS Chief Counsel and the Office of the Assistant Commissioner (Employee Plans and Exempt Organizations) with respect to technical advice requests results in significant delays in the processing of such requests and contributes to a reluctance by certain IRS Key District Office employees to submit such requests for technical advice. These delays contributed to a perception that the IRS was not treating all tax-exempt organizations consistently. The Joint Committee staff concluded that the delays in processing such requests were unnecessarily excessive in some cases.
- The Joint Committee staff found no credible evidence that the IRS had improperly targeted for examination individuals related to tax-exempt organizations within the scope of the Joint Committee staff investigation.

IRS use of information items in the tax-exempt organization area

- The Joint Committee staff found no credible evidence that the IRS systematically used information items (such as media reports, letters from Members of Congress, letters from taxpayers, etc.) to identify for examination tax-exempt organizations that espouse views that are opposed to the political views of the Clinton Administration. Prior to the middle of 1998, most IRS Key District Offices destroyed information items when a decision was made not to pursue the item. Thus, the Joint Committee staff could not evaluate whether there was a pattern of behavior by the IRS in the handling of information items that resulted in certain organizations being selected for examination and other organizations engaged in similar activities not being selected for examination. The Joint Committee staff found that the IRS had initiated examinations of certain tax-exempt organizations with views clearly in opposition to the Clinton Administration based on media reports and other information items provided to the IRS. The Joint Committee staff found that the IRS also initiated examinations of organizations that would be considered supportive of the Clinton Administration based on such information items.

- The Joint Committee staff found a few instances in which the stated IRS National Office policy of sending information items without comment to the appropriate IRS Key District Office was not followed and the IRS National Office memorandum transmitting an information item contained statements as to the IRS National Office view of either the law or the relevance of the information item. The Joint Committee staff did not find any credible evidence that the IRS National Office attempted to influence IRS Key District Office decisions on whether to initiate examinations of tax-exempt organizations.
- Certain media reports raised issues relating to statements attributed to an IRS employee concerning the handling of Congressional inquiries relating to tax-exempt organizations. According to the reports, the IRS employee allegedly stated (1) that IRS employees had been or were shredding documents identifying the names of Members of Congress and their staff as the sources of examination requests and (2) suggesting ways to disguise information items received from Members of Congress. The Joint Committee staff reviewed documentation provided by the IRS relating to the IRS employee's statements. According to the documentation, the IRS employee's statements concerning the shredding of documents related to the previous practice in the IRS Key District Offices of destroying information items that did not result in an audit. The employee's statements with respect to the attribution of information items received from Members of Congress related to the concern raised by an IRS Office of Inspection Internal Audit report (discussed in detail below) that recommended identifying a media report as the source of an information item relating to a tax-exempt organization even if a taxpayer or a Member of Congress forwards such media report to the IRS.
- The Joint Committee staff found no credible evidence that Congressional inquiries had improperly altered the manner in which the IRS handled tax-exempt organization cases.
- The Joint Committee staff found no credible evidence that information items forwarded to the IRS by the Treasury Department or the White House were given more weight by the IRS than information items received from other sources.

Employee misconduct with respect to tax-exempt organization matters

- The Joint Committee staff found no credible evidence that any IRS employee had improperly altered the outcome of a tax-exempt organization case. The Joint Committee staff found that the IRS had procedures in place to ensure that political appointees, such as the Commissioner of Internal Revenue and the IRS Chief Counsel, did not generally become involved in the resolution of issues relating to specific taxpayers.
- The Joint Committee staff found that allegations of IRS employee misconduct with respect to organizations within the scope of the Joint Committee staff investigation that were referred to the IRS Office of Inspection were thoroughly investigated by IRS management and the IRS Office of Inspection and disciplinary action, if warranted, was taken.

- The Joint Committee staff found that instances of employee misconduct or other issues relating to organizations within the scope of the Joint Committee staff investigation that were referred to the Treasury Inspector General's office were lost, misplaced, or not investigated by the Inspector General. The Joint Committee staff found no credible evidence that this failure to investigate referrals by the Inspector General's office occurred as a result of a concerted effort to protect high-ranking IRS and Treasury Department officials. Rather, it appeared that these failures to investigate resulted from lack of accountability, recordkeeping failures, and incompetence within the Inspector General's office.
- The Joint Committee staff identified eight instances of alleged IRS employee misconduct relating to organizations within the scope of the Joint Committee staff investigation. With respect to these eight instances, the Joint Committee staff found the following:
 - Two instances related to statements made by IRS employees to representatives of tax-exempt organizations under examination by the IRS. In each instance, the IRS employee's statements were interpreted by the representative of the tax-exempt organization to indicate that there was bias in the handling of the examination by the IRS. The Joint Committee staff found that the IRS employees' statements were ambiguous. In addition, based upon interviews of IRS employees by the Joint Committee staff and based upon records of interviews conducted by the IRS Office of Inspection and the Treasury Inspector General, the Joint Committee staff found that the IRS employees did not intend their statements to mean what the statements had been interpreted to mean by the representatives of the tax-exempt organizations.
 - Three instances related to allegations made by tax-exempt organizations that IRS employees assigned to the tax-exempt organizations' cases were biased, based generally on information the tax-exempt organization had about the political views of the IRS employees. In one instance, the case was transferred to the IRS National Office based on the issues involved and the IRS employee had no further involvement in it. In the other two instances, the IRS either reassigned the case in question to another IRS employee or added IRS employees to the case to ensure that individual IRS employee bias would not occur.
 - One instance related to an allegation that IRS employees had violated the church audit procedures contained in Code section 7611. The Joint Committee found that the contact made by IRS employees was done to educate the relevant church as to the law with respect to impermissible political campaign intervention by organizations described in section 501(c)(3). See the discussion in Part III.B., concerning the Joint Committee staff's findings with respect to the church audit procedures.
 - One instance involved allegations of potential misconduct identified by one IRS employee with respect to the actions of the employee's supervisor. Based on the

available information and evidence and the statements of the IRS employee and the employee's supervisor, the Joint Committee staff found no credible evidence that the supervisor had acted in a manner intended to influence improperly either the initiation or conduct of examinations of tax-exempt organizations.

- One instance involved an allegation of an improper attempt to obtain information by an employee of the Office of IRS Chief Counsel with respect to the examination of a tax-exempt organization within the scope of the Joint Committee staff investigation. The Joint Committee staff found no credible evidence that the employee had acted in a manner intended to influence improperly the handling of the examination by the IRS.
- Allegations of IRS employee misconduct with respect to the handling of tax-exempt organization cases are not recorded in a single IRS data base and the IRS does not have a comprehensive system in place to identify all such allegations. In order to respond to Joint Committee staff requests with respect to allegations of employee misconduct, the IRS surveyed managers in the IRS National Office and IRS Key District Offices to determine their recollections of any such allegations. This manager survey identified one allegation that was also identified through one of the two relevant IRS databases. However, due to the lack of a comprehensive data base, the Joint Committee staff was unable to evaluate systematically whether all instances of alleged IRS employee misconduct with respect to tax-exempt organizations within the scope of the Joint Committee staff investigation were located.
- The Joint Committee staff found evidence of two nonroutine contacts of IRS employees made by White House and Treasury officials.
 - In the first instance, the Joint Committee staff found evidence of a single nonroutine direct contact in 1997 between White House officials and the IRS in which the White House officials appear to have attempted to obtain taxpayer return information to which they were not entitled under section 6103. Because the tax-exempt organization in question was not an organization described in section 501(c)(3) or (c)(4), the contact was outside of the scope of the Joint Committee investigation and, therefore, was not extensively reviewed. However, limited materials reviewed by Joint Committee staff indicated that the contact related to the status of certain forms filed by members of a tax-exempt organization. It appears that White House officials initially contacted employees in the Treasury Office of Tax Policy and were referred, in apparent violation of Treasury Order 107-05, directly to the IRS. The White House officials then, in violation of written White House policies, contacted directly several IRS employees (none of whom worked in the Exempt Organization Division) and attempted to secure taxpayer return information. The Joint Committee staff found that the IRS employees involved (1) refused to disclose taxpayer return information protected under section 6103; and (2) promptly referred the contact to the Treasury Inspector General.

- In the second instance, a Treasury Department official was alleged to have made a 1995 inquiry to IRS employees concerning the status of an examination of a tax-exempt organization within the scope of the Joint Committee staff investigation. One of the IRS employees contacted in connection with the inquiry was sufficiently concerned about the nature of the contact that a referral was made to the IRS Office of Inspection. As the matter pertained to a Treasury Department official, the IRS Office of Inspection referred the matter to the then-Treasury Inspector General's office.¹⁰ The Treasury Inspector General did not act upon the referral until it was brought to the Inspector General's attention during the Joint Committee staff investigation during 1997. When asked about the referral by the Joint Committee staff, the Treasury Inspector General's office could not locate it and had no record of any action taken with respect to the referral. Materials received by the Joint Committee staff from the Treasury Inspector General's office in 1999 indicate that the Inspector General received a copy of the referral in July 1997 and assigned an investigator to it. There was no evidence of any other action by the Treasury Inspector General with respect to this referral after September 1997. During 1999, following further Joint Committee staff inquiries with respect to the referral, the Treasury Inspector General for Tax Administration investigated the allegations made with respect to this contact and found that the evidence concerning the nature of the contact made by the Treasury official was inconclusive. However, the Treasury Inspector General for Tax Administration did not find any evidence that the IRS handling of the examination of the tax-exempt organization in question was improper. The Joint Committee staff interviewed all parties involved in this contact and reviewed IRS and Treasury records, including the relevant case file. The Joint Committee staff found no credible evidence that the contact by the Department of Treasury employee influenced the conduct or outcome of the examination.

Other investigations

Prior to and during the Joint Committee staff investigation, the IRS Office of Inspection, the Treasury Inspector General, and the Treasury Inspector General for Tax Administration conducted a number of investigations into the IRS processes relating to tax-exempt organizations generally and into allegations relating to IRS employee handling of certain cases specifically. The Joint Committee staff had access to all information obtained by or generated by these offices in connection with the various investigations.

¹⁰ There is conflicting information regarding the timing of the referral by the IRS Office of Inspection to the Treasury Inspector General. IRS Office of Inspection records indicate that the referral was forwarded in 1995; however, the Treasury Inspector General's office had no record of receiving the referral prior to July, 1997.

II. SUMMARY OF ALLEGATIONS

Present-law section 501(c) provides for 27 different categories of nonprofit organizations that generally are exempt from Federal income tax.¹¹ The IRS Office of the Assistant Commissioner Employee Plans and Exempt Organizations¹² is responsible for administering the law relating to such tax-exempt organizations.

Prior to the commencement of the Joint Committee staff investigation, allegations were made through certain media reports that the IRS was engaged in politically targeted examinations of tax-exempt organizations.¹³ For example, a Wall Street Journal editorial on January 9, 1997, indicated that there had been charges made that IRS audits of tax-exempt organizations were politically motivated.¹⁴ A January 17, 1997, article in the Washington Times stated that a spot survey of tax-exempt organizations that were perceived to be “right of center” found that at least seven of such organizations were under examination by the IRS and a spot survey of prominent “liberal” groups found none of such organizations were under examination.¹⁵ Additional allegations were made in other media reports and in submissions to, and by individuals interviewed by, the Joint Committee staff in connection with its investigation.

In general, the allegations can be summarized as follows:

(1) the IRS delayed or refused to issue determination letters to certain organizations either because the organization was perceived to represent views that were opposed to the Clinton Administration or because individual IRS employees were opposed to the views of the organization;

¹¹ These so-called “tax-exempt organizations” generally are exempt from Federal income tax on income derived from activities that are substantially related to their exempt purposes and on their investment income. Such organizations generally are subject to tax on any income derived from regularly carried on business activities that are not substantially related to their exempt purposes.

¹² Under Commissioner Rossotti’s reorganization plan, this office is being reorganized into the Tax-Exempt and Government Entities Operating Division.

¹³ See Exhibit 1-1 for a listing of some of these articles.

¹⁴ “*Politics and the IRS*,” Review and Outlook, The Wall Street Journal, January 9, 1997.

¹⁵ Scarborough, Rowan, “*IRS audits target conservative groups*,” The Washington Times, January 17, 1997.

(2) the IRS inappropriately granted determination letters or expedited the granting of determination letters for organizations whose political views were in line with those of the Clinton Administration;

(3) the IRS targeted for examination tax-exempt organizations (and individuals associated with such organizations) that opposed or were critical of the Clinton Administration's policies and did not examine organizations that espoused policies favored by the Clinton Administration;

(4) the IRS subjected tax-exempt organizations opposed to the Clinton Administration to more intensive and intrusive examinations than the examinations to which other organizations were subjected;

(5) the IRS inappropriately initiated examinations of certain tax-exempt organizations in response to information provided to the IRS by the White House or other influential individuals (e.g., Members of Congress) whose views aligned with the Clinton Administration in opposition to the organizations targeted;

(6) IRS reliance on information received from third parties, including media reports, in the examination selection process created an indirect bias inherent in the audit selection process against organizations with views opposed to the Clinton Administration; and

(7) the actions of certain IRS employees assigned to audits of tax-exempt organizations whose views were in opposition to the Clinton Administration raised questions concerning the IRS's handling of the audit.

Although some of the allegations related to IRS actions with respect to political and lobbying activities of specific tax-exempt organizations, other allegations related to more general targeting by the IRS of organizations with views opposed to the Clinton Administration. Thus, the Joint Committee staff investigation focused on a review of (1) how the IRS generally administered the law relating to the political and lobbying activities of tax-exempt organizations, (2) how the IRS generally administered determination letter requests of tax-exempt organizations, (3) how the IRS generally selected tax-exempt organizations for audit, and (4) the IRS handling of matters relating to certain specific tax-exempt organizations.

III. INVESTIGATION FINDINGS

Most of the information supplied by the IRS to the Joint Committee staff in the course of its investigation constitutes taxpayer return information that cannot be disclosed pursuant to section 6103 of the Internal Revenue Code.¹⁶ Thus, the Joint Committee staff findings below do not include any specific findings of the Joint Committee staff with respect to the organizations and individuals within the scope of the Joint Committee staff investigation or any information that might identify such organizations or individuals. These findings represent the general conclusions drawn by the Joint Committee staff from its extensive review of IRS case file information, other information received from the IRS, other Federal agencies, and other sources, and interviews with relevant Federal employees and others.

A. Determination Letter Process

Allegations

With respect to the IRS's handling of determination letter requests of tax-exempt organizations, allegations were made that: (1) the IRS had delayed or refused to issue a determination letter to certain organizations either because the organization was perceived to represent views that were opposed to the Clinton Administration or because individual IRS employees were opposed to the views of the organization; or (2) the IRS had granted determination letters or expedited the granting of determination letters for organizations whose views were more in line with those of the Clinton Administration. Of the specific cases identified by the Joint Committee staff and the IRS as relevant to the Joint Committee investigation,¹⁷ nine involved allegations relating to the handling of determination letter requests.

Findings

- The Joint Committee staff found no credible evidence that the IRS had delayed or accelerated issuance of determination letters to tax-exempt organizations based on the nature of the organization's perceived views.
- The Joint Committee staff found that determination letter applications that were merit screened (i.e., approved by a technical screener on the basis of information contained in the application) were processed, on average, much faster than other determination letter applications. The Joint Committee staff found no credible evidence that IRS employees selectively processed applications of tax-exempt organizations through the merit

¹⁶ Unauthorized disclosure of tax return information protected under section 6103 is a felony punishable by a fine of up to \$5,000, imprisonment for up to five years, or both.

¹⁷ See the discussion in Part IV., concerning the process by which cases were identified as relevant to the Joint Committee staff investigation.

screening process nor did the Joint Committee staff find any evidence of IRS bias with respect to the determination letter applications that were merit screened. The Joint Committee staff found that the procedures for merit screening of determination letter applications for tax-exempt organizations were sufficiently structured and controlled as to make the possibility of such selectivity or bias remote.

- The Joint Committee staff found that certain determination letter applications took much longer than average for the IRS to process. In particular, determination letter applications that were forwarded to the IRS National Office took much longer, on average, to process than applications processed at the IRS Key District Office level. The Joint Committee staff found that delays at the IRS National Office and IRS Key District Office levels were caused by a variety of factors, including (1) taxpayer delays in responding to IRS requests for information, (2) IRS workload constraints, and (3) internal IRS disputes concerning interpretations of present law. The Joint Committee staff found that the delay in processing the determination letter application of one organization was unacceptably slow, but the Joint Committee staff found no credible evidence of either bias by IRS employees or inappropriate intervention by IRS employees or other individuals causing the delay.
- The Joint Committee staff found that there were inconsistencies in the way in which certain determination letter applications were handled by the IRS. Some taxpayers were granted determination letters in a fairly routine manner by an IRS Key District Office while the determination letter applications of other taxpayers with apparently similar issues were forwarded by a different IRS Key District Office to the IRS National Office for handling. However, the Joint Committee staff found no credible evidence that any one IRS Key District Office handled similar determination letter applications inconsistently. Further, the Joint Committee staff found no credible evidence that the forwarding of certain determination letter applications to the IRS National Office was the result of a deliberate effort by IRS employees to subject organizations with views that opposed the Clinton Administration to more intense scrutiny. The inconsistencies in treatment could be traced to (1) differences in the statements made by organizations on their determination letter applications as to the organizations' purposes, (2) the failure of IRS employees to understand the circumstances under which determination letter applications should be forwarded to the IRS National Office, and (3) differences in information provided to the IRS relating to potential operations of the organizations in question.

Observations

The nine determination letter applications reviewed by the Joint Committee staff were received by the IRS during a period of time in which hundreds of thousands of determination letter applications were received and processed. The Joint Committee staff found no credible

evidence of determination letter applications being handled differently by the IRS depending on the nature of the organization's perceived political views.

However, the differences in the manner in which certain determination letter applications were handled may have created perceptions of bias or inconsistent treatment by the IRS. To counter these perceptions, the IRS needs to work aggressively to ensure that these perceptions do not occur. Certain changes in IRS operations that have occurred subsequent to the inception of the Joint Committee staff investigation are steps in the right direction.

For example, the move by the IRS to centralize the processing of determination letter requests in a single IRS Key District Office may address certain of the problems identified by the Joint Committee staff. With centralization of the determination letter process, IRS management (through the Review staff function) should be better able to monitor the handling of determination letter cases to ensure that (1) merit screenings are done in appropriate circumstances, (2) consistent standards are applied to determine whether an application should be forwarded to the IRS National Office, and (3) workload problems that create delays in processing are minimized.

A problem that will not be addressed by centralization of the processing of determination letter requests is the additional delays that occur when such requests are forwarded to the IRS National Office. In such cases, disputes between the IRS Assistant Commissioner's office and the IRS Office of Chief Counsel on interpretations of present law can significantly increase the time it takes the IRS to process a determination letter application.¹⁸ These delays may contribute to the perception that the IRS's handling of certain cases is biased or politically motivated. The Joint Committee staff recommends that the IRS adopt internal procedures and controls to ensure that such internal disputes do not delay inappropriately the processing of determination letter applications.

¹⁸ See the discussion of this issue in Part III.B.

B. Examination Process

Allegations

Allegations were made that the IRS targeted for audit tax-exempt organizations that opposed, or were critical of, the Clinton Administration's policies. A variation of this allegation was that, among tax-exempt organizations audited, those that were opposed to the Clinton Administration generally were subjected to more intensive and intrusive audits than were other organizations.

Under some circumstances, allegations were made that individual IRS employees were biased against organizations with views that opposed those of the Clinton Administration. In other instances, it was alleged that members of the Clinton Administration exerted pressure on IRS employees to initiate audits of tax-exempt organizations (or individuals related to tax-exempt organizations) whose views were opposed to the Clinton Administration. See the discussion in Part III.D. for the Joint Committee staff findings relating to this element of the investigation.

Conversely, it was alleged that organizations that espoused policies favored by the Administration were not audited.

In addition to the allegations of direct bias, there were allegations of indirect bias inherent in the process by which the IRS selects organizations for audit because of reliance on information received from third parties, including the media. These allegations are specifically addressed in Part III.C.

Of the specific cases identified by the Joint Committee staff and the IRS as relevant to the Joint Committee staff investigation, 121 related to the initiation (or failure to initiate) and the conduct of audits of tax-exempt organizations and/or individuals related to such organizations.

Findings

- The Joint Committee staff found no credible evidence that tax-exempt organizations were selected for examination based on the views espoused by the organizations or individuals related to the organization.
- The Joint Committee staff found no credible evidence that the IRS altered the manner in which an examination was conducted based on the views espoused by the organization or individuals related to the organization.
- The Joint Committee staff found no credible evidence of intervention by Clinton Administration officials in the selection of (or the failure to select) tax-exempt organizations for examination.

- The Joint Committee staff found that certain cases involving high-profile tax-exempt organizations and individuals received more internal review and scrutiny by the IRS; however, the Joint Committee staff found no credible evidence that such increased review or scrutiny was politically motivated. In some cases, the increased scrutiny appeared to be an effort by the IRS to ensure that the audit was conducted in a fair and impartial manner. In other cases, the increased scrutiny appeared to be motivated by concerns over potential negative media reports relating to IRS actions.
- In its review of the IRS tax-exempt organization examination function, the Joint Committee staff found that the interaction between the Office of IRS Chief Counsel and the IRS Assistant Commissioner (Employee Plans and Exempt Organizations) with respect to technical advice requests results in significant delays in the processing of such requests and contributes to a reluctance by certain IRS Key District Office employees to submit such requests. Disputes between IRS Chief Counsel attorneys and IRS National Office Exempt Organization Division employees with respect to interpretations of present-law rules relating to impermissible political campaign intervention leads to unacceptable delays in the processing of technical advice requests. These delays contribute to the perception that the IRS is not treating all tax-exempt organizations consistently. While the interaction between the Office of IRS Chief Counsel and the Assistant Commissioner's office create institutional safeguards that protect against bias on the part of any one IRS employee from influencing the outcome of a technical advice request, the Joint Committee staff concluded that the delays in processing such requests were unnecessarily excessive in one case.
- The Joint Committee staff found no credible evidence that certain tax-exempt organizations were subjected to more intrusive examinations than other organizations. As part of the review of this allegation, the Joint Committee staff found that a number of the cases within the scope of the Joint Committee staff investigation were coordinated examination program ("CEP") examinations. Because of the higher level of scrutiny by the IRS in the case of a CEP examination, the Joint Committee staff reviewed the extent to which the cases within the scope of the Joint Committee investigation were properly treated as CEP cases. The Joint Committee staff found no credible evidence that the IRS used the CEP program improperly to subject tax-exempt organizations to more intrusive audits.
- Certain of the allegations investigated by the Joint Committee staff related to IRS actions with respect to churches, particularly with respect to alleged impermissible political campaign activity by certain churches. Under present law, special procedures are statutorily required to be followed by the IRS prior to initiation of an examination of a church. These procedures are referred to as the "church audit procedures." The Joint Committee staff found that the church audit procedures, while providing important safeguards against the IRS engaging in unnecessary examinations of churches, also have

the effect of (1) making it more difficult for the IRS to initiate an examination of a church even if there is clear evidence of impermissible activity on the part of the church and (2) hampering IRS efforts to educate churches with respect to actions that are not permissible, such as what constitutes impermissible political campaign intervention.

- The Joint Committee staff found no credible evidence that the IRS improperly targeted for examination individuals related to organizations within the scope of the Joint Committee staff investigation. With respect to such individuals, the Joint Committee staff found that (1) individuals who alleged that their tax returns had been selected for examination by the IRS had not been so selected or (2) the IRS had used normal audit selection processes to identify an individual's return for examination.

Observations

Procedural problems

While the Joint Committee staff found no credible evidence of political bias in the IRS's selection of tax-exempt organizations for audit or the conduct of such audits, the Joint Committee staff did identify certain procedural and substantive problems with IRS audit processes that may have contributed to a perception of unfairness and may have hampered the IRS's ability to demonstrate unbiased treatment.

From a procedural standpoint, the Joint Committee staff noted that the IRS needs to improve recordkeeping with respect to the reasons that a tax-exempt organization is or is not selected for audit (e.g., handling of third party referrals). No standardized requirements were previously in place regarding the tracking, retention, or evaluation of referrals; in many cases, referrals that did not result in an audit were thrown away, preventing the Joint Committee staff from conducting any meaningful analysis of organizations selected for examination versus those not selected. In addition, every IRS Key District Office operated under differing standards, resulting in a lack of nationwide procedural uniformity. In response to the 1997 Internal Audit report, the IRS has implemented a new system whereby all information items are tracked, evaluated, and retained in a standardized manner throughout every IRS Key District Office with audit responsibilities.¹⁹ If properly utilized, the new system should correct past inadequacies and should assist the IRS in demonstrating the impartiality of its selection process should the need to do so arise again.

Further, although the IRS maintains a computerized database through which it can identify tax-exempt organizations that are currently, or have been, under examination, the quality of the information contained in the database varies in detail and reliability. For example, when a tax-exempt organization is under examination, the IRS database is required (under IRS procedures) to identify the primary issues involved in the audit. However, senior IRS officials admit that IRS employees commonly use inconsistent or no issue codes when the database is

¹⁹ See the detailed discussion of the Internal Audit report in Part V.C.

updated. Thus, it is very difficult to identify tax-exempt organizations in the various IRS Key District Offices that have the same issues under audit. It is difficult for an independent review of IRS practices to obtain an accurate summary of IRS examination activity given these database failures. Improved communications with and training of IRS employees about the importance of ensuring that accurate information is maintained in IRS databases may help resolve some of these problems.

The IRS needs to improve communications with taxpayers to ensure that taxpayers are aware of the reason for and timing of examinations. Evasiveness on the part of IRS employees gives rise to unnecessary suspicions on the part of taxpayers. Legislative requirements regarding information to be provided to taxpayers that was enacted as part of the IRS Reform Act should be helpful in this regard.²⁰

In addition, the IRS should consider additional training of its employees with respect to taxpayer communications. In a number of cases reviewed by Joint Committee staff, statements made to taxpayers by IRS employees gave rise to suspicions that the IRS was treating a tax-exempt organization unfairly or in a manner inconsistent with the treatment of other taxpayers. When questioned about these statements by Joint Committee staff, the IRS employees indicated that they did not intend the statements to be interpreted as they were by the taxpayers.

Substantive law

The law regarding political and lobbying activities of tax-exempt organizations contributes to a perception of disparate treatment of tax-exempt organizations. The rules are complex and rely heavily on facts and circumstances determinations with respect to which reasonable individuals might reach different conclusions.

Given the ambiguities and complexities inherent in present law, the IRS needs to develop and implement consistent substantive ruling positions on political and lobbying activities of tax-exempt organizations and consistent procedures for handling difficult issues. The decentralized nature of the IRS examination process means that the IRS Key District Offices have complete autonomy with respect to the handling of examination cases. Accordingly, it is imperative that the IRS Key District Offices have sufficient guidance to evaluate substantive issues. The lack of such guidance at the IRS Key District Office level results in what are apparent policy reversals as a case moves through the IRS. Facts and issues are developed at the IRS Key District Office level; if such findings are adverse to the taxpayer such that revocation of tax-exempt status would result, the case is moved up the chain of review, ultimately to the IRS National Office. While such review is desirable, it may result in what appears to the taxpayer to be inconsistent IRS

²⁰ The IRS Reform Act contained a number of provisions to improve IRS disclosure of information and notice to taxpayers, including a requirement that the IRS include in Publication 1 a description of the criteria and procedures for selecting taxpayers for examination.

positions if the IRS National Office takes a position inconsistent with the IRS Key District Office position.

The present system for providing formal guidance (e.g., Technical Advice Memoranda) to the IRS Key District Offices exacerbates the perception of inconsistent treatment and bias that may have led to the allegations resulting in the Joint Committee staff investigation. The manner in which difficult issues are handled results in significant delays in final IRS decisions. Taxpayer favorable results in the IRS Key District Offices are not subjected to the same level of review as taxpayer adverse results. Thus, cases involving taxpayer favorable results are resolved more expeditiously. These systemic problems are particularly pervasive in cases involving difficult legal issues.

The interactions between IRS National Office and IRS Key District Office employees and between the Office of IRS Chief Counsel and attorneys in the IRS District Counsel offices contribute to perceptions of bias. When formal guidance is requested by IRS Key District Office and IRS District Counsel employees, the time taken to process a case can be extended significantly. IRS Key District Office employees interviewed by Joint Committee staff indicated that they were reluctant to submit cases to the IRS National Office through the Technical Advice Request process because of the additional time it took to close a case submitted for technical advice. Taxpayers may perceive that these delays result from bias by IRS employees.

Another factor that may contribute to perceptions of bias is that informal guidance provided by IRS National Office personnel and Office of IRS Chief Counsel attorneys may be based on an incomplete understanding of the facts in a case. In addition, informal guidance to IRS Key District Office and IRS District Counsel employees may result in miscommunication with respect to the guidance being provided, particularly if the legal issues, such as what constitutes impermissible lobbying and political activity, are difficult. These miscommunications lead on occasion to changes in IRS position that taxpayers may believe result from IRS employee bias.

There often are differences of opinion throughout the IRS as to the proper interpretation of the law for a given set of facts. On the one hand, such internal debate helps to ensure that a final position is well-considered. On the other hand, such internal debate may result in institutional paralysis. In several cases the Joint Committee staff reviewed, the latter result occurred. In this regard, the role of the Office of IRS Chief Counsel vis-a-vis the IRS National Office is critical to consider. In the last several years, certain tax-exempt organization examinations were delayed because of disputes in the interpretation of present law between the Office of IRS Chief Counsel and the IRS National Office. No formal system exists by which such disputes are resolved although there is a reconciliation process by which the issue in dispute is reviewed by high ranking IRS officials. In some instances, this process resulted in unacceptable delays in the processing of cases. These delays can result from a disagreement essentially between two employees -- the employee responsible for a case in the IRS National Office and an attorney in the Office of IRS Chief Counsel. In recent cases, the IRS National

Office and the Office of IRS Chief Counsel formed working groups to try to address legal issues submitted to the IRS National Office through the technical advice request process. In at least one instance, the working group method was utilized because the statute of limitations for the organization under audit was expiring within a relatively short period of time. The IRS should consider formalizing this working group procedure to improve the analysis of legal issues at the IRS National Office level and to speed the processing of such issues in cases presenting difficult legal issues or issues of first impression. The use of a working group would also reduce the likelihood that a single employee (either in the IRS National Office or in the Office of IRS Chief Counsel) will delay the processing of a case.

IRS management also needs to ensure that adequate controls of case inventories are in place to assure that overage cases (i.e., cases that have exceeded the time recommended by the IRS National Office for completion) are handled as expeditiously as possible, particularly with respect to cases forwarded to the IRS National Office.

Certain of the allegations investigated by the Joint Committee staff related to churches, particularly with respect to alleged impermissible political campaign activity by certain churches. The Joint Committee staff found that the church audit procedures provide important safeguards against the IRS engaging in unnecessary examinations of churches. However, the procedures also have the effect of (1) making it more difficult for the IRS to initiate an examination of a church even where there is clear evidence of impermissible activity on the part of the church and (2) hampering IRS efforts to educate churches with respect to actions that are not permissible, such as what constitutes impermissible political campaign intervention. The Joint Committee staff believes that a change in the church audit procedures to clarify that the IRS may undertake educational and outreach activities with respect to specific churches (e.g., initiating meetings with representatives of a particular church to discuss the rules that apply to such church) without the initiation of a full church tax inquiry would improve compliance with the law by churches.

C. Processing of Information Items

Allegations

Certain of the allegations relating to IRS handling of tax-exempt organization matters asserted that the IRS reacted in an improper manner to information received from sources outside the IRS (“information items”) with respect to tax-exempt organizations.²¹ Specifically, allegations were made that (1) the IRS initiated audits of certain tax-exempt organizations in response to information provided to the IRS by the White House or other influential individuals (e.g., Members of Congress) whose views aligned with the Clinton Administration in opposition to the organizations targeted and (2) the IRS relied on media reports to target for audit tax-exempt organizations whose views were in opposition to the Clinton Administration.

Some individuals alleged that there was an inherent bias in the use of media reports as information items because many of the prominent media sources tend to be liberal. The allegation was made that these liberal media sources reported more about possible improper activity of conservative tax-exempt organizations and less about possible improper activity of liberal tax-exempt organizations. Thus, it was suggested that the IRS, in relying on such media reports, was likely to skew its audits of tax-exempt organizations toward organizations that are more likely to have conservative views.

Of the cases identified by the Joint Committee staff and the IRS as relevant to the Joint Committee investigation, 90 of the organizations were identified through media reports. However, the fact that an organization was identified as relevant to the Joint Committee investigation through media reports did not necessarily mean that the organization (1) was in fact under audit by the IRS or (2) was selected for audit by the IRS because of such media reports.

Findings

- The Joint Committee staff found that the IRS initiates examinations of tax-exempt organizations based on media reports and other information items provided to the IRS. The Joint Committee staff found that, during the period under review, media reports and other information items led to examinations both of tax-exempt organizations with views clearly in opposition to the Clinton Administration and of tax-exempt organizations that would be considered supportive of the Clinton Administration. Prior to the middle of 1998, most IRS Key District Offices destroyed information items when a decision was made not to pursue them. The Joint Committee staff was able to review selected batches of incoming and outgoing correspondence, particularly at the IRS National Office level,

²¹ The IRS treats all information that comes to the attention of the IRS outside of the normal scope of work on a taxpayer case as information items. The sources of information can include information received from letters submitted to the IRS, media reports, and other sources, such as a referral from another IRS office or another government agency. A detailed discussion of IRS handling of such information items is in Part V.C.1.

and interviewed IRS employees with respect to the handling of information items generally and with respect to specific tax-exempt organization cases. However, because of the way in which the IRS handled such information items prior to 1998, the Joint Committee staff could not evaluate whether there was a pattern of behavior by the IRS with respect to information items that resulted in certain organizations being selected for examination and other organizations engaged in similar activities not being selected for examination.

- The Joint Committee staff found that information items, including media reports, result in a relatively small percentage (ranging from 5-10 percent) of tax-exempt organization examinations commenced each year. The percentages tended to be higher following election years, which appeared to occur because of increased media attention on tax-exempt organizations involved in political campaign activity or in the distribution of voter guides.
- The IRS National Office has a written policy of sending, without comment, to the appropriate IRS Key District Office any information item that comes to the attention of the IRS National Office. The Joint Committee staff did not find any credible evidence that the IRS National Office attempted to influence IRS Key District Office decisions on whether to initiate examinations of tax-exempt organizations. However, the Joint Committee staff found a few instances in which the stated IRS National Office policy was not followed and the IRS National Office memorandum transmitting an information item contained statements as to the IRS National Office view of either the law or the relevance of the information item. For example, in one instance, the Joint Committee staff found that a memorandum from the IRS National Office to an IRS Key District Office forwarding a Congressional inquiry stated that, if the allegations made in the inquiry were accurate, it appeared that there was a legitimate issue for the IRS Key District Office to review. However, every IRS Key District Office employee interviewed by Joint Committee staff indicated that the IRS National Office memoranda in this particular case had no effect on the IRS Key District Office decision whether or not to pursue an information item.
- Certain media reports raised issues relating to statements attributed to an IRS employee concerning the handling of Congressional inquiries relating to tax-exempt organizations. According to reports, the IRS employee allegedly (1) stated that IRS employees had been or were shredding documents identifying the names of Members of Congress and their staff as the sources of examination requests and (2) suggested ways to disguise information items received from Members of Congress. The Joint Committee staff reviewed documentation provided by the IRS relating to the IRS employee's statements. According to the documentation, the IRS employee's statements relating to shredding of documents concerned the previous practice in the IRS Key District Offices of destroying information items that did not result in an audit. As noted below, the IRS has changed this practice in response to the Internal Audit report issued in June of 1998. In addition, the IRS employee's statements with respect to the attribution of information items

received from Members of Congress related to the concern raised by the Internal Audit report that the IRS did not have a consistent system in place for identifying the source of information items. This issue relates to how the IRS indicates the source of information when an intermediary submits information to the IRS. The Internal Audit report recommended that the IRS Key District Offices use a source code that identifies the original source of information items, rather than intermediary sources. Thus, for example, under IRS procedures as modified pursuant to the Internal Audit report, the IRS will identify a media report as the source of an information item relating to a tax-exempt organization even if a taxpayer or a Member of Congress forwards such media report to the IRS.

- During the period January 1, 1994, through April 22, 1997, the IRS National Office received nearly 500 inquiries from Members of Congress relating to tax-exempt organizations. Inquiries made to the IRS by Members of Congress are generally handled under expedited procedures at all levels of the IRS. Fewer than 5 percent of the requests received by the IRS appeared to be Congressional requests for review of the activities of a tax-exempt organization that were not initiated because of a constituent inquiry to the Member of Congress. Although IRS procedures require that all Congressional inquiries be expedited, the Joint Committee staff did not find that these written Congressional inquiries influenced in any improper manner the actions of the IRS with respect to any tax-exempt organization within the scope of the investigation.
- In virtually every instance of a Congressional inquiry reviewed by the Joint Committee staff, it appeared that the inquiry could be characterized as either (1) an inquiry made on behalf of a constituent or (2) a valid exercise of Congressional oversight over IRS operations. Every current IRS employee interviewed by the Joint Committee staff stated that inquiries made by Members of Congress (or Congressional staff) had never improperly influenced the way in which the IRS handled specific tax-exempt organization cases. A former IRS employee stated that he felt that one contact made by staff of a Member of Congress had come close to improper attempts to influence the handling of a tax-exempt organization case by the IRS, but that such contact had not affected the way the IRS handled the case in question. Thus, the Joint Committee staff found no credible evidence that Congressional inquiries had improperly altered the manner in which the IRS handled tax-exempt organization cases.
- The Joint Committee staff reviewed 107 documents found in files of Treasury Department officials relating to specific tax-exempt organizations. The Joint Committee staff found no credible evidence in these documents of improper Treasury Department involvement in IRS matters relating to such organizations.
- The Joint Committee staff reviewed summaries of 117 pieces of correspondence (including Congressional correspondence) to the Treasury Department relating to specific tax-exempt organizations. The Joint Committee staff requested detailed follow-up information with respect to 29 of these pieces of correspondence. The Joint Committee

staff found no credible evidence of improper Treasury Department handling of any such correspondence.

- The Joint Committee staff reviewed the manner in which the IRS handled information with respect to tax-exempt organizations forwarded to the IRS by the White House and interviewed IRS employees concerning their handling of tax-exempt organization matters in instances in which information was forwarded to the IRS by the White House. The Joint Committee staff found no credible evidence that the IRS either initiated an audit of a tax-exempt organization or altered the handling of a tax-exempt organization case because of pressure from the White House. In addition, the Joint Committee staff found no credible evidence that information items referred to the IRS by the White House were given more weight by the IRS than information items received from other sources.
- The Joint Committee staff reviewed 1,246 entries in correspondence logs of the White House for 1996 and 1997 with respect to matters referred to the IRS. The Joint Committee staff also reviewed White House procedures with respect to the handling of correspondence relating to matters under the jurisdiction of the IRS. The Joint Committee staff found no credible evidence that any of the letters to the White House included in the correspondence logs reviewed by the Joint Committee staff had been handled in a nonroutine manner. Further, the Joint Committee staff found no credible evidence that the White House had attempted to influence the handling of any tax-exempt organization matter within the scope of the Joint Committee staff investigation. However, although there is a written White House policy prohibiting employees from directly contacting the IRS with respect to matters relating to specific taxpayers, in one instance, the stated White House policy was not followed (see the discussion in Part III.D.).
- In response to a Joint Committee staff written request for communications between the White House and the IRS or the Treasury Department, the White House Counsel's Office conducted an extensive search of White House records and identified no cases in which media reports relating to tax-exempt organizations were forwarded to the IRS or Treasury Department. The Joint Committee staff found one instance in which an IRS case file for a tax-exempt organization within the scope of the Joint Committee staff investigation and under examination by the IRS contained a copy of correspondence with an attached media report that had been sent by a taxpayer directly to the White House and was forwarded by the White House to the IRS. According to the White House Counsel's Office, information received by the White House with respect to specific taxpayers is not logged onto White House correspondence systems and is sent in bulk to the Treasury Department, which sends it without comment to the IRS. There was no evidence in the IRS case files or in other IRS information reviewed by the Joint Committee staff to indicate that the correspondence found by the Joint Committee staff had been forwarded to the IRS in a nonroutine manner.

Observations

Information items

During the period under investigation, both the Joint Committee staff and the IRS Office of Inspection identified significant problems with the way in which information items were handled by the IRS. In particular, the Joint Committee staff identified a lack of consistent written procedures at IRS Key District Office and IRS National Office levels with respect to the handling of information items. Such offices had inconsistent policies for receipt, control, and retention of information items. In most cases, the IRS Key District Offices did not retain information items if such items did not lead to initiation of IRS action with respect to a tax-exempt organization.

These failures by the IRS made it impossible for Joint Committee staff to review original documents on the handling of information items for patterns of behavior. The Joint Committee staff did review the handling of information items relating to organizations within the scope of the Joint Committee staff investigation if the information item resulted in the commencement of an examination. However, information items that did not result in the commencement of an examination could not be reviewed systematically because certain IRS Key District Offices did not previously retain copies of information items if an examination was not begun.²² Although the Joint Committee staff did not observe any apparent patterns in which information items were used to initiate examinations of tax-exempt organizations that had views that were opposed to the Clinton Administration, the lack of consistent recordkeeping prevented the Joint Committee staff from engaging in any systematic review of the handling of such items. The Joint Committee staff found that information items led to the initiation of examinations of tax-exempt organizations with views opposed to the Clinton Administration and of tax-exempt organizations that would be considered supportive of the Clinton Administration.

As a result of an Internal Audit report issued by the IRS Office of Inspection in June 1998 in response to a referral by IRS Assistant Commissioner (Employee Plans and Exempt Organizations) Evelyn Petschek, the IRS has adopted new procedures for the handling of information items relating to tax-exempt organizations. These procedures will not preclude the possibility of IRS employees using information items selectively or inappropriately. However, by requiring consistent recordkeeping and handling, the new procedures should improve the ability of independent bodies, such as the Treasury Inspector General for Tax Administration, to oversee the use of information items by the IRS.

The Internal Audit report recommended that the IRS National Office should maintain a log of information items forwarded to the IRS Key District Offices, which would include the date received, the source of the item, and the date sent to the IRS Key District Office. The Internal Audit report further recommended that the IRS Key District Offices should advise the IRS National Office of the disposition of these items. This may or may not be desirable. Such a

²² As noted below, the IRS procedures for handling information items have changed.

requirement would inevitably place a higher priority at the IRS Key District Office level on referrals received through the IRS National Office. It could also give the appearance that the IRS National Office is involved in the selection of tax-exempt organizations for audit.

The Internal Audit report also recommended that the IRS adopt a uniform system for tracking information items in all of the IRS Key District Offices so that the IRS National Office would have query capabilities and the ability to generate reports on the handling of information items.

In certain circumstances, the IRS National Office failed to follow its stated policy that information items must be forwarded to the IRS Key District Offices without comment. This raised questions of whether IRS National Office personnel intended to influence the decision of the IRS Key District Office with respect to the handling of such information items. The Joint Committee staff interviewed both IRS National Office and IRS Key District Office employees with respect to the instances in which IRS National Office procedures were not followed. IRS National Office employees interviewed by the Joint Committee staff stated that the IRS National Office personnel did not intend to influence the IRS Key District Offices handling of information items in these instances and were merely trying to provide additional information to assist the IRS Key District Offices. IRS Key District Office employees interviewed by the Joint Committee staff said that the additional information supplied by the IRS National Office in the referrals in question did not influence the IRS Key District Office's handling of the information items. However, IRS Key District Office employees did point out that they believed that the IRS National Office would not forward a media report (such as a newspaper article) unless IRS National Office personnel believed that the media report warranted further action at the IRS Key District Office level.

Congressional inquiries

Members of Congress (and Congressional staff) have the potential to influence the way in which the IRS conducts its business. Because the funding of IRS operations is dependent on the Congress, the IRS responds more promptly to, and takes more seriously, requests and inquiries made by Members of Congress than requests made by taxpayers. The Joint Committee staff found that no IRS employee interviewed by the Joint Committee staff felt that there had been improper attempts by Members of Congress to influence IRS employees with respect to the handling of specific tax-exempt organization cases. The Joint Committee staff found a number of Congressional inquiries had been made with respect to IRS handling of cases within the scope of the Joint Committee staff investigation. These inquiries either (1) forwarded a constituent letter questioning the legality of a tax-exempt organization's activities, (2) questioned directly the activities of the tax-exempt organization and asked the IRS to investigate, or (3) questioned IRS actions relating to a tax-exempt organization. The Joint Committee staff notes that this is an area in which the potential for improper influence can exist because there can be a fine line between legitimate Congressional oversight activities and improper pressure with respect to the handling of a specific tax-exempt organization case.

D. Employee Conduct Issues

Allegations

In several instances, allegations were made that IRS employees or Clinton Administration officials had acted improperly with respect to the handling of tax-exempt organization cases. The allegations suggested that the improper behavior stemmed from a bias either for an organization with views in support of the Clinton Administration or against an organization with views opposed to the Clinton Administration. Of the cases reviewed by the Joint Committee staff, eight involved questions relating to the conduct of specific IRS employees. In addition, the Joint Committee staff investigated instances of possible improper conduct by Treasury Department and White House employees.

Findings

- The Joint Committee staff found that there are sufficient procedural controls in the IRS handling of tax-exempt organization cases to make it highly unlikely that an individual IRS employee can improperly alter the outcome of a tax-exempt organization case. In addition, IRS policies reduce the likelihood that political appointees, such as the Commissioner of Internal Revenue or the IRS Chief Counsel, can become directly involved in the resolution of issues relating to specific taxpayers.
- The Joint Committee staff identified 18 instances in which IRS employees or others were accused of bias or other misconduct with respect to the handling of tax-exempt organization cases. Eight of the instances related to organizations within the scope of the Joint Committee staff investigation. In those instances in which such accusations were made and a referral was made to the IRS Office of Inspection, the Joint Committee staff found that the employee conduct issues generally were thoroughly investigated by IRS management and the IRS Office of Inspection. In each of these instances, the Joint Committee staff found that IRS management acted promptly to (1) investigate the alleged misconduct, (2) minimize the risk of improper employee behavior by assigning additional or different employees to the cases in question, and (3) discipline the employee, if appropriate.
- Of the eight instances of alleged IRS employee misconduct relating to organizations within the scope of the Joint Committee staff investigation, the Joint Committee staff found the following:
 - Two instances related to statements made by IRS employees to representatives of tax-exempt organizations under examination by the IRS. In each instance, the IRS employee's statements were interpreted by the representative of the tax-exempt organization to indicate that there was bias in the handling of the examination by the IRS. The Joint Committee staff found that the IRS employees' statements were ambiguous. In addition, based upon interviews of IRS employees by the Joint

Committee staff and based upon records of interviews conducted by the IRS Office of Inspection and the Treasury Inspector General, the Joint Committee staff found that the IRS employees did not intend their statements in the manner the statements were interpreted by the representatives of the tax-exempt organizations.

- Three instances related to allegations made by tax-exempt organizations that IRS employees assigned to the tax-exempt organizations' cases were biased, based generally on information the tax-exempt organization had about the political views of the IRS employees. In one instance, the case was transferred to the IRS National Office based on the issues involved in the case (i.e., not as a result of the allegation of employee bias) and the IRS employee had no further involvement in it. In the other two instances, the IRS Office of Inspection investigated the allegations, but did not find any evidence that the employees had exhibited any bias. However, in order to eliminate any appearance of impropriety, the IRS either reassigned the case in question to another IRS employee or added IRS employees to the case to ensure that individual IRS employee bias would not occur.
- One instance related to an allegation that IRS employees had violated the church audit procedures contained in Code section 7611. The Joint Committee staff found that the contact made by IRS employees was intended to educate the church as to the law with respect to impermissible political campaign intervention by organizations described in section 501(c)(3). See the discussion in Part III.B., concerning the Joint Committee staff's findings with respect to the church audit procedures.
- One instance involved allegations of potential misconduct identified by one IRS employee with respect to the actions of the employee's supervisor. Based on the available information and the statements of the IRS employee and the employee's supervisor, the Joint Committee staff found no credible evidence that the supervisor had acted in a manner intended to influence improperly either the initiation or conduct of examinations of tax-exempt organizations.
- One instance involved an allegation of an improper attempt to obtain information by an employee of the Office of IRS Chief Counsel with respect to the examination of a tax-exempt organization within the scope of the Joint Committee staff investigation. The Joint Committee staff found no credible evidence that the employee had acted in a manner intended to influence improperly the handling of the examination by the IRS.
- Allegations of IRS employee misconduct with respect to the handling of tax-exempt organization cases are not recorded in a single IRS data base and the IRS does not have a comprehensive system in place to identify all such allegations. In order to respond to Joint Committee staff requests with respect to allegations of employee misconduct, the IRS surveyed managers in the IRS National Office and IRS Key District Offices to determine their recollections of any such allegations. This manager survey identified one

allegation that was also identified through one of the two relevant IRS databases. However, due to the lack of a comprehensive data base, the Joint Committee staff was unable to evaluate systematically whether all instances of alleged IRS employee misconduct with respect to tax-exempt organizations within the scope of the Joint Committee staff investigation were located.

- The Joint Committee staff found that IRS employees are frequently reminded of the integrity with which they are expected to perform their duties. Every IRS employee interviewed by the Joint Committee staff volunteered that they would not hesitate to report any instance in which they believed that an individual, whether another IRS employee or someone else, was attempting to influence improperly the outcome of a tax-exempt organization case. In support of these statements, the Joint Committee staff found referrals of possible misconduct, by IRS employees and other individuals, had been made by IRS employees to the IRS Office of Inspection.
- The Joint Committee staff found that IRS employees generally made referrals only to the IRS Office of Inspection even if the referral was more appropriately made to the Treasury Inspector General's office under the Memorandum of Understanding then in effect between those two offices. The Joint Committee staff also found that instances of employee misconduct or other issues that were referred by the IRS Office of Inspection to the Treasury Inspector General's office were routinely lost, misplaced, or not investigated by the Inspector General. The Joint Committee staff found no credible evidence that this failure to investigate referrals by the Treasury Inspector General's office occurred as a result of a concerted effort to protect high-ranking IRS and Treasury Department officials. Rather, it appeared that these failures to investigate resulted from lack of accountability, recordkeeping failures, and incompetence within the Inspector General's office.
- The Joint Committee staff found evidence of two nonroutine contacts of IRS employees made by White House and Treasury officials.
 - In the first instance, the Joint Committee staff found evidence of a single nonroutine direct contact in 1997 between White House officials and the IRS in which the White House officials appear to have attempted to obtain taxpayer return information that may not be disclosed under section 6103. Because the tax-exempt organization in question was not an organization described in section 501(c)(3) or (c)(4), the contact was outside of the scope of the Joint Committee investigation and, therefore, was not extensively reviewed. However, limited materials reviewed by Joint Committee staff indicated that the contact related to the status of certain forms filed by members of a tax-exempt organization. It appears that White House officials initially contacted employees in the Treasury Office of Tax Policy and were referred, in apparent violation of Treasury Order 107-05, directly to the IRS. The White House officials then, in violation of written White House policies, contacted several IRS employees (none of whom worked in the EO Division) and attempted to secure taxpayer return information. The Joint Committee staff found that the IRS employees involved (1)

refused to disclose taxpayer return information protected under section 6103; and (2) promptly referred the contact to the Treasury Inspector General.

- In the second instance, a Treasury Department official was alleged to have made a 1995 inquiry to IRS employees concerning the status of an audit of a tax-exempt organization. One of the IRS employees contacted in connection with the inquiry was sufficiently concerned about the nature of the contact that a referral was made to the IRS Office of Inspection. As the matter pertained to a Treasury Department official, the IRS Office of Inspection referred the matter to the Treasury Inspector General's office.²³ The Treasury Inspector General did not act upon the referral until it was brought to the Inspector General's attention during the Joint Committee staff investigation in 1997. When asked about the referral by the Joint Committee staff, the Treasury Inspector General's office could not locate it and had no record of any action taken with respect to the referral. Materials received by the Joint Committee staff from the Treasury Inspector General's office in 1999 indicate that the Inspector General received a copy of the referral in July 1997 and assigned an investigator to it. There was no action by the Treasury Inspector General with respect to this referral after September 1997. During 1999, following further Joint Committee staff inquiries with respect to the referral, the Treasury Inspector General for Tax Administration investigated the allegations made with respect to this contact and found that the evidence concerning the nature of the contact made by the Treasury official was inconclusive. However, the Treasury Inspector General for Tax Administration did not find any evidence that the IRS handling of the examination of the tax-exempt organization in question was improper. The Joint Committee staff interviewed all parties involved in this contact and reviewed IRS and Treasury records, including the relevant case file. The Joint Committee staff found no credible evidence that the contact by the Department of Treasury employee influenced the conduct or outcome of the examination.

Observations

Employee conduct in general

The IRS has a longstanding unwritten policy in place to insulate political appointees, such as the Commissioner of Internal Revenue and the IRS Chief Counsel, from involvement in the decision making with respect to most specific taxpayer matters. The Joint Committee staff recommends that such policies be formalized and reduced to writing. A formal written policy would reduce the possibility that political appointees could become involved inappropriately in taxpayer specific matters.

²³ There is conflicting information regarding the timing of the referral by the IRS Office of Inspection to the Treasury Inspector General. IRS Office of Inspection records indicate that the referral was forwarded in 1995; however, the Treasury Inspector General's office had no record of receiving the referral prior to July, 1997.

The Joint Committee staff believes that it is important that Administration officials, particularly those working for the Department of Treasury and the White House, be reminded periodically of the Administration policy against such officials intervening in taxpayer-specific matters. The Joint Committee staff found that the instances of nonroutine contacts made to the IRS with respect to tax-exempt organization matters by Administration officials apparently occurred despite the formal policies of the Administration prohibiting such contacts. These types of contacts lend credence to the allegations that the Administration does intervene in IRS matters pertaining to specific taxpayers. While the Joint Committee staff did not find any credible evidence of efforts by Administration officials to influence the operations of the IRS with respect to specific tax-exempt organizations (or individuals associated with such tax-exempt organizations), the fact that these contacts occur at all could raise issues concerning the integrity of the system. The Joint Committee staff found that IRS employees handled the nonroutine contacts properly and were not influenced in any way by the Administration officials who contacted them. In addition, the IRS employees in question all recognized the impropriety of the contacts and made referrals to the IRS Office of Inspection concerning the contacts.

Every current and former IRS employee interviewed by the Joint Committee staff stated that personal and organization integrity in the handling of specific taxpayer matters was of the utmost importance. IRS employees indicated to the Joint Committee staff that they are constantly reminded of the importance of doing their work in an unbiased and fair manner. Some IRS employees noted that, from time to time, employee pay stubs will advise IRS employees of the way in which they can make referrals of possible misconduct. Many IRS employees indicated that they would not hesitate (and have not hesitated) to make referrals to the IRS Office of Inspection when they thought that someone was improperly trying to influence the outcome of a case to which they were assigned.

The Joint Committee staff observed that IRS employees tended to refer issues of employee misconduct to the former IRS Office of Inspection even if the referral should have been referred to the former Treasury Inspector General's office. Although IRS employees were often advised about their rights to make referrals concerning employee misconduct, the employees were not adequately advised with respect to the appropriate office to which to direct the referral. The restructuring of the IRS Office of Inspection into the Treasury Inspector General for Tax Administration should eliminate this problem by centralizing all referrals in one office.

Specific allegations

In the course of the interviews of IRS employees, some of the most serious allegations of potential employee misconduct were identified by one IRS employee with respect to the actions of the employee's supervisor. The IRS employee interviewed stated that the employee's supervisor had attempted to influence the handling of tax-exempt organization cases.²⁴ In the

²⁴ The employee in question initially refused to answer certain questions posed by the Joint Committee staff during an interview with the employee in late 1997. At the time of the first

first allegation, the employee stated that the supervisor pushed for the implementation of a workplan in the tax-exempt organizations area that would have involved the examination of mostly conservative organizations to address political activity in the 1994 election cycle. The IRS employee stated that he was assigned to a different position for a temporary period because he refused to implement the workplan. The employee's supervisor indicated that the workplan in question was identified as a possible local project by the IRS National Office, but that there was no accountability if such a project was not undertaken. The Joint Committee staff reviewed the workplan and found no credible evidence that the IRS National Office workplan was intended to, or would result in, increased audits of conservative tax-exempt organizations relative to other tax-exempt organizations. The IRS National Office workplan guidelines in no way required the examination of tax-exempt organizations with particular views. The IRS National Office workplan was not implemented. Further, the employee's supervisor indicated that the employee volunteered for the temporary assignment, which was to a position of equal grade and that the employee was well suited for the temporary assignment because of the employee's particular expertise and experience. Finally, the alleged statements of the supervisor cited by the IRS employee were ambiguous and did not clearly reflect an attempt to target conservative tax-exempt organizations for audit.

The IRS employee further alleged that the supervisor attempted to influence improperly the outcome of at least one sensitive and complex case within the scope of the Joint Committee staff investigation by assigning an individual as manager of the case who, in the IRS employee's opinion, did not have the experience or ability to oversee the case. The employee's supervisor stated that there was no intent to influence the outcome of the audit in question and that the employee in question was assigned only temporarily to the case until another employee could be assigned to it.

The IRS employee alleged that the supervisor had directed the employee to look into media reports concerning a particular tax-exempt organization and, in the employee's words, "provide an alibi." The Joint Committee staff asked the employee to indicate for whom the employee was asked to provide an alibi and for what actions. In the employee's follow-up response, the employee recanted and stated that no one specifically asked the employee to provide an alibi, but stated that the employee felt that the supervisor had suggested that the employee reach a particular conclusion. The supervisor stated that the employee had been asked to find out what had happened with respect to the tax-exempt organization and report back to the supervisor.

The IRS employee made similar allegations to the Treasury Inspector General for Tax Administration in late 1998. The Treasury Inspector General for Tax Administration did not find any credible evidence supporting the IRS employee's allegations.

Joint Committee interview, the employee had a personnel grievance pending against the employee's supervisor. The Joint Committee staff subsequently received written responses from the IRS employee to the Joint Committee staff's questions. The Joint Committee staff requested and received additional responses to questions from the employee in late 1998.

Treasury Inspector General

Although not specifically part of its investigation, the Joint Committee staff noted that the Treasury Inspector General's office frequently lost, misplaced, or simply did not investigate referrals made to it by IRS employees or referred to it by the IRS Office of Inspection under the Memorandum of Understanding in effect at the time. As a result of this failure to act on referrals, allegations made with respect to employee misconduct by high-ranking IRS and Treasury Department officials were either not investigated or were not investigated in as thorough a manner as referrals made with respect to other IRS employees.²⁵ The Joint Committee staff found no credible evidence that this failure to investigate referrals by the Inspector General's office occurred as a result of a concerted effort to protect high-ranking IRS and Treasury Department officials. Rather, it appeared that these failures to investigate resulted from lack of accountability and recordkeeping failures within the Inspector General's office. However, the fact that the Treasury Inspector General failed to investigate allegations relating to a Treasury official even after the Joint Committee staff repeatedly asked about the referral raises questions as to the motives of the Treasury Inspector General employees. The restructuring of the IRS Office of Inspection and the Treasury Inspector General may reduce the likelihood of these failures occurring in the future.

²⁵ Under the Memorandum of Understanding then in effect, all allegations relating to Treasury Department employees and high-ranking IRS employees were required to be investigated by the Treasury Inspector General and the IRS Office of Inspection had no jurisdiction with respect to such investigations.

IV. METHODOLOGY OF JOINT COMMITTEE STAFF INVESTIGATION

The investigation of the Joint Committee staff entailed extensive review of public and private records relating to tax-exempt organizations (and individuals related to tax-exempt organizations). The following discussion outlines the general methodology employed by the Joint Committee staff in conducting the investigation.

A. Identification of Organizations And Individuals Within the Scope of the Investigation

The Joint Committee staff identified tax-exempt organizations (and individuals related to such organizations) that were potentially within the scope of the Joint Committee investigation through the following sources:

- Media reports in which issues relating to the handling of tax-exempt organizations by the IRS were discussed;
- Letters to the Joint Committee staff and other contacts from individuals and tax-exempt organizations concerning allegations of improper treatment by the IRS;
- Organizations identified by the IRS as currently having a determination letter request pending or as currently under audit in which allegations of improper political or lobbying activity by the organization were involved;
- Organizations identified by the IRS Office of Inspection and the Treasury Inspector General in connection with investigations of those offices into allegations that the IRS was engaged in politically motivated examinations of tax-exempt organizations; and
- Organizations and individuals to whom subpoenas were issued by the Senate Governmental Affairs Committee in connection with its investigation of campaign irregularities during the 1996 Presidential campaign.

From these sources, the Joint Committee staff identified 142 organizations and individuals potentially within the scope of the investigation. Eight organizations and individuals were eliminated when it was determined that the allegations made were not properly within the scope of the Joint Committee investigation. Other organizations that had been identified in media reports could not be located on the IRS Exempt Organizations/Business Master File²⁶ or through other research by the IRS.

²⁶ The IRS Exempt Organizations/Business Master File is the computerized IRS database that tracks all tax-exempt organizations for which the IRS has a record.

With respect to the more than 130 remaining organizations and individuals, the Joint Committee staff received briefings and/or summary materials prepared by IRS National Office personnel relating to (1) the status of each of the organizations (i.e., as a section 501(c)(3) or 501(c)(4) organization), (2) whether the organization was currently or previously had been under examination by the IRS, (3) whether a pending determination letter request was involved, and (4) the primary issues involved in the case. Based upon the IRS National Office briefings and other materials made available to Joint Committee staff (e.g., by tax-exempt organizations), the Joint Committee staff identified those organizations and individuals for which extensive case file reviews were conducted to evaluate the IRS's conduct with respect to the taxpayers.

B. Case File Review

The Joint Committee staff reviewed complete IRS case files, as well as other related files, with respect to 83 organizations and individuals. The Joint Committee staff reviewed hundreds of boxes of case file materials supplied by the IRS from its various offices. The way in which the IRS identified and secured relevant case file information is detailed below.

In response to requests by Joint Committee staff, IRS National Office employees conducted searches for cases and case file information in their own files, IRS Chief Counsel files, and the files of IRS employees in the IRS management chain up to and including the Office of the Commissioner. The IRS National Office also sent a memorandum to each IRS Region requesting that a search be conducted of every office that might have information relating to a Joint Committee staff request for case file information. At the IRS National Office's request, the search was conducted in the following locations: the Regional Commissioner's office, the office of the Regional Analyst with Employee Plans and Exempt Organization jurisdiction, the Office of the District Director of the Employee Plans and Exempt Organization Key District Office, and all Employee Plans and Exempt Organization and Criminal Investigation Division offices within the IRS Key District Office. The IRS National Office directed that the search include all responsive information relating to organizations within the IRS Region's or IRS Key District Office's jurisdiction. The IRS National Office requested that each office provide information relating to the persons who conducted the search and the search methodology and methods used.

Relevant case file information from the IRS Key District Offices and IRS Region offices were forwarded to the IRS National Office. The IRS provided a secure location within the IRS National Office for Joint Committee staff to review the case files without interference by IRS National Office personnel. Joint Committee staff reviewed certain IRS Key District Office, IRS Region, and IRS District Counsel case files in the IRS Key District Offices where the files were located. Joint Committee staff traveled to posts of duty within the Western and Southeast Key District Offices for on-site review of case file information.

The Joint Committee staff separately requested case file and other information from the IRS Office of Inspection and the Treasury Inspector General.

C. Meetings, Interviews and On-Site Visits

Meetings

The Joint Committee staff met extensively with IRS National Office personnel on matters relating to the Joint Committee staff investigation. Among the topics covered in these meetings were the following:

- briefings on cases that IRS National Office personnel had identified as involving allegations of impermissible political activity as an issue;
- briefings on cases identified by the Joint Committee staff;
- overall review of IRS procedures relating to determination letter requests and examinations of tax-exempt organizations; and
- review of the role of the IRS National Office in tax-exempt organization matters.

The Joint Committee staff met with employees of the IRS Office of Inspection with respect to its investigation into allegations that the IRS was conducting politically motivated audits of tax-exempt organizations.

The Joint Committee staff met with the Treasury Office of Inspector General, which conducted an investigation that was coexistent with the IRS Office of Inspection investigation.²⁷ The Joint Committee staff met on several occasions with the office of the Treasury Inspector General for Tax Administration.

The Joint Committee staff sent a letter to representatives of each tax-exempt organization that had been mentioned in media reports. Included in the letter was an invitation to meet with Joint Committee staff or, alternatively, a request to complete a questionnaire relating to the IRS's handling of issues relating to the tax-exempt organization. Representatives of ten organizations agreed to meet with the Joint Committee staff. Most of the meetings took place in Joint Committee offices, although one meeting was conducted during a Joint Committee staff visit to the Western Key District Office.

²⁷ On February 18, 1997, the Treasury Inspector General notified the IRS of its intent to commence a review of the IRS in the near future. Specifically, the Treasury Inspector General intended to: (1) assess the IRS management initiatives concerning tax-exempt organizations and selection criteria for related tax audits; (2) evaluate the internal audit and investigative coverage provided by the IRS Office of Inspection of IRS programs related to tax-exempt organizations; and (3) analyze the tax audits planned, started, or performed. The Treasury Inspector General completed its first two objectives and discontinued work on the third in light of the Joint Committee staff investigation.

Interviews

The Joint Committee staff interviewed 57 IRS and other Federal officials relating to the allegations of politically motivated treatment by the IRS in general and specifically with respect to certain of the cases for which the allegations had been made. The interviews were conducted at Joint Committee offices and at various IRS offices, including the IRS National Office, the Western and Southeast Key District Offices, the Ohio Key District Office, and the IRS offices in Landover, Maryland. In addition, the Joint Committee staff had access to the interview records and sworn affidavits of both the IRS Office of Inspection and the Treasury Inspector General with respect to the approximately 65 individuals interviewed by those organizations in connection with their separate investigations.

Each individual interviewed by the Joint Committee staff was asked a consistent set of questions concerning the following issues: (1) whether the employee had ever been contacted by anyone at the IRS outside of his or her normal chain of supervisors with respect to a specific tax-exempt organization case and, if yes, what the circumstances were and how the contact was handled; (2) whether the employee had ever been contacted by anyone at the Treasury Department, the White House, or any other executive branch agency with respect to a specific tax-exempt organization case and, if yes, what the circumstances were and how the contact was handled; (3) whether the employee had ever been contacted by a Member of Congress or a staff person of a Member of Congress with respect to a specific tax-exempt organization case and, if yes, what the circumstances were and how the contact was handled; (4) whether the employee had ever been directed or had pressure exerted on him or her to handle a specific tax-exempt organization case in a particular manner and, if yes, what the circumstances were; (5) whether the employee ever directed or pressured an IRS employee under his or her authority to handle a specific tax-exempt organization case in a particular manner; (6) whether the employee was aware of any instances in which other IRS employees may have had pressure exerted on them to handle a specific tax-exempt organization case in a particular manner and, if yes, what the circumstances were as the employee understood them; (7) whether the employee was aware of any instance in which the handling of a tax-exempt organization case (or of an individual related to a tax-exempt organization) by the IRS was altered from what it otherwise would have been for politically motivated reasons and, if yes, what the circumstances were; and (8) whether the employee had ever made a referral to the IRS Office of Inspection or the Treasury Inspector General or otherwise reported a case relating to a tax-exempt organization (or an individual relating to a tax-exempt organization) because the employee thought there was improper behavior (by an IRS employee, other government employee, Member of Congress, Congressional staff member, or an individual related to the tax-exempt organization) and, if yes, what the circumstances were.

In addition, IRS employees and other Federal officials were asked case specific information in instances in which such individuals were involved with, or otherwise had knowledge of, cases within the scope of the Joint Committee staff investigation.

On-site visits

For much of the investigation, the Joint Committee staff worked in the IRS National Office located in Washington, D.C. In addition, the Joint Committee staff conducted on-site visits to the Southeast, Ohio, and Western Key District Offices, as well as to the IRS District Counsel office and Washington post of duty in Washington, D.C. The Joint Committee staff also conducted a walk-through of the exempt organization determination letter processing systems, which are located at the IRS Service Center located in Covington, Kentucky.

D. Review of Other IRS Materials

The Joint Committee staff requested and reviewed certain IRS materials that may be relevant to the investigation or that may have contained information relating to organizations within the scope of the Joint Committee investigation that was not otherwise contained in IRS case files.

Management information

The Joint Committee staff received and reviewed the following periodic reports prepared by the IRS relating to tax-exempt organization matters for the period 1990 through 1997:

- Copies of all annual workplans or business plans for each region's tax-exempt organization review activities;
- Reports of Significant Matter in Employee Plans and Exempt Organizations;
- All reports from the IRS National Office Exempt Organizations Branches (and their predecessors);
- Quarterly narrative reports from the IRS Key District Office;
- Quarterly monitoring reports to the IRS Key District Office;
- Employee Plans and Exempt Organizations sensitive case reports – generally prepared by the IRS Key District Offices for the District Director;
- Employee Plans and Exempt Organizations National Office status reports of over-age technical advice requests;
- Selected Employee Plans and Exempt Organizations National Office charts of cases pending in the IRS National Office;
- Briefing materials from the Director of the Exempt Organizations Division to the Assistant Commissioner or from the Assistant Commissioner's office that

included any reference to organizations for which the Joint Committee staff had requested information;

- Descriptions of all open and closed local and IRS National Office projects regarding tax-exempt organizations;
- Files containing the results of the Field Compliance review of Exempt Organization National Office referrals to the IRS Key District Offices during fiscal years 1994, 1995, and 1996 to identify those referrals regarding political and/or legislative activities;
- Eight binders of materials located in the Southeast Key District Office Branch Chief's office containing referral material and workplan material as well as various other materials from 1988 to the present; and
- Media evangelist reports prepared by the IRS for the House Committee on Ways and Means Subcommittee on Oversight.

Joint Committee staff reviewed IRS Exempt Organization staffing levels, broken down by location and by function (e.g., determination letter, examination, policy, etc.) and IRS funding levels for the tax-exempt organization oversight function.

Internal tracking systems for correspondence and cases

The Joint Committee staff met with IRS personnel responsible for creating and maintaining computerized databases of information relating to tax-exempt organizations. In the course of these meetings, the Joint Committee staff were briefed on the types of databases used by the IRS and the information contained in each such database. In addition, the Joint Committee staff was given access to information contained on the IRS databases.

Included in the databases reviewed by the Joint Committee staff were the following:

- AIMS -- the Audit Information Management System;
- EACS -- the EP/EO Application Control System;
- EDS -- EP/EO Determination System;
- EO/BMF -- Exempt Organizations/Business Master File;
- ETS -- EP/EO Technical Time System;
- IDRS -- Integrated Data Retrieval System;
- CEMIS -- Coordinated Examination Management Information System;
- ECMS -- Executive Control Management System; and
- Exempt Organizations Case Tracking System.

As part of this review of IRS databases, the Joint Committee staff reviewed all Congressional correspondence received by the IRS National Office during the period 1995-1997.

In addition, the Joint Committee staff reviewed the applicable databases for information relating to other information items, such as media reports and inquiries by taxpayers. This database review was used to verify information otherwise identified by the Joint Committee staff in the course of IRS case file reviews or provided to the Joint Committee staff by individuals interviewed or otherwise contacted in connection with the Joint Committee staff investigation.

Determination letter data

The Joint Committee staff received data from the IRS relating to tax-exempt organization determination letter activity. With respect to the determination letter process, the Joint Committee staff reviewed IRS data for determination letters requested from organizations requesting tax-exempt status as organizations described in Code sections 501(c)(3) and 501(c)(4) and data relating to the processing of determination letter requests of all organizations seeking tax-exempt status. The IRS provided this information for the period from July 16, 1993, in the case of IRS Key District Office data and from January 1, 1992, in the case of IRS National Office data (i.e., cases disposed of in the IRS National Office). Included in this data review was the following information:

- Name of the organization;
- Code section in which the organization is described;
- Foundation code (for private foundations);
- Type of entity and nature of primary activity;
- Date request received;
- Disposition of request (i.e., granted, denied, withdrawn, or pending), including date of disposition; and
- Description of any subsequent proceeding.

The Ohio Key District Office of the IRS is responsible for the processing of determination letter requests related to tax-exempt organizations. At the beginning of the Joint Committee staff investigation, the IRS was transferring responsibility for all determination letter processing to the Ohio Key District Office. The Joint Committee staff made an on-site visit and walkthrough of the determination letter processing center in the Ohio Key District Office as well as the Service Center in Covington, Kentucky, where applications are received and initially processed before transmittal to the Ohio Key District Office.

Examination process data

As part of its investigation, the Joint Committee staff reviewed the examination process as it applies to tax-exempt organizations. The Joint Committee staff reviewed aggregate data supplied by the IRS regarding its overall examination program (for the period from 1990 through 1997) for tax-exempt organizations including:

- Number of returns surveyed (i.e., closed without commencement of an audit);
- Number of returns surveyed before assignment to a revenue agent;

- Number of returns surveyed after assignment to a revenue agent; and
- Number of tax-exempt organization returns completed by examination category (including Code subsection, employment tax, etc.).

IRS processing of information items

The Joint Committee staff reviewed information derived from IRS management information systems (to the extent available) regarding information items received in the IRS National Office and in the IRS Key District Offices for the period from 1990 through 1997. As previously noted, IRS recordkeeping with respect to information items during this period was inconsistent and, in many cases, incomplete. Thus, there was no way for the Joint Committee staff to verify systematically the handling of information items by the IRS National Office and IRS Key District Offices. The Joint Committee staff reviewed all logs or other recordkeeping systems that were maintained by the IRS with respect to information items. In some cases, the IRS Key District Offices either did not maintain a log or record of the handling of information items or maintained only a record of information items that warranted further IRS action.

The Joint Committee staff reviewed stated IRS procedures for the handling of information items and reviewed, to the extent information was available, IRS handling of information items to determine whether the actual handling of such information items conformed to IRS procedures.

Joint Committee staff interviewed IRS National Office and Key District Office employees with respect to the handling of information items. The Joint Committee staff asked relevant IRS employees questions relating to the following issues:

- The handling of information items, including whether IRS employees followed applicable IRS procedures;
- The circumstances in which the IRS National Office may have directed or encouraged the IRS Key District Offices to take specific action with respect to identified information items;
- The extent to which media and other reports are relied on in the selection of tax-exempt organizations for audit;
- Estimates of the percentage of tax-exempt organization audits open within IRS Key District Offices that were initiated because of media reports or other third party inquiries;
- The extent to which the procedures for selecting cases for audit differ depending on the potential issues involved;
- The extent to which referrals from the IRS National Office are given more or less weight than other referrals and whether the IRS National Office inquired, formally or informally, about whether or not a referral resulted in an audit;
- How Congressional inquiries/referrals are handled, whether a record of such inquiries is maintained, how such records are maintained (e.g., computerized record or handwritten log), and who is responsible for maintaining the record;

- How third party referrals (including media reports) are handled within the employee's division; and
- Whether a record of such inquiries is maintained in the division, how such records are maintained (e.g., computerized record or handwritten log), and who is responsible for maintaining the record.

Congressional correspondence

The Joint Committee staff reviewed information derived from IRS management information systems regarding Congressional inquiries received from 1990 to the present. The IRS Office of Legislative Affairs provided information available under its tracking system. The IRS also provided a list of Congressional correspondence from the PROMIS system. The Joint Committee staff reviewed all general and Congressional correspondence received by the Exempt Organizations Division over a 14-month period along with a review of the responses to such correspondence. Chronology correspondence files from the IRS Office of the Assistant Commissioner for Employee Plans and Exempt Organizations were also reviewed.

Internal Revenue Manual

The Joint Committee staff reviewed the procedures contained in the Internal Revenue Manual with respect to processing of determination letter requests, examinations of tax-exempt organizations, handling of information items, and employee conduct.

Employee conduct

In connection with its investigation, the Joint Committee staff reviewed the policies and procedures of the IRS, the Treasury Department, and the White House with respect to employee involvement in specific taxpayer matters. The Joint Committee staff reviewed the ethical requirements applicable to such employees, the written guidelines provided to employees, and the manner in which such policies and procedures are implemented. The Joint Committee staff reviewed records of instances in which IRS employees or other executive branch officials were accused of bias or improper behavior with respect to tax-exempt organization matters.

The Joint Committee staff requested from the IRS copies of any written materials provided to or made available to IRS employees that defined the circumstances under which an IRS employee is required to recuse himself or herself from an assigned case and a description of how IRS employees are informed of these rules. The Joint Committee staff requested any written IRS guidance describing situations under which an IRS employee should or may recuse himself or herself from a matter involving a tax-exempt organization because of the employee's political affiliation, membership in an organization, or philosophy or other ideology.

The Joint Committee staff review included the following:

- Document 9076 (1-93) (IRS' Office of Government Ethics ("OGE") Standards of Ethical Conduct; Self Study Guide);
- Document 9077 (1-93) (OGE Standards of Ethical Conduct for Employees of the Executive Branch);
- Document 9335 (11-94) (Interim Handbook of Employee Conduct and Ethical Behavior);
- 5 C.F.R. part 3101 (Supplemental Standards of Ethical Conduct for Employees of the Treasury Department) (May 5, 1995);
- 31 C.F.R. part 0 (Department of the Treasury Employee Rules of Conduct) (June 1, 1995);
- Document 7098 (Rev. 5-89) (Internal Revenue Service Rules of Conduct);
- Executive Orders 12674 and 12731;
- Internal Revenue Manual 7(10)41.1 (9-14-90);
- Internal Revenue Manual 7(10)69-3, 130 (11-27-91);
- Internal Revenue Manual 4200, subsection 42(11)5.2 (5)(b) (3-15-95);
- Internal Revenue Manual 7130 (4-24-79); and
- 18 U.S.C. 208(a).

Joint Committee staff requested from the IRS (including the IRS Office of Inspection) and the Treasury Inspector General a list of all instances, from January 1, 1990, through 1997, in which IRS employees (or other Administration officials) had been accused of exhibiting bias or otherwise interfering with any cases involving tax-exempt organizations. To provide this information, the IRS National Office contacted the offices of the Assistant Chief Counsel (General Legal Services), Assistant Chief Inspector, Executive Support, Labor Relations, and Taxpayer Advocate. In addition, the IRS National Office requested in writing that IRS Key District Offices for Employee Plans and Exempt Organizations and the Exempt Organization Division of the IRS National Office conduct a survey of managers to determine if they had personal knowledge of instances of alleged bias.

From the period 1990 through 1997, there were 18 instances in which allegations were made of improprieties (by IRS employees and by others) with respect to cases involving tax-

exempt organizations. Eight of these instances involved organizations within the scope of the Joint Committee staff investigation.

The IRS National Office also reviewed the ability of certain management information systems, including the Automated Labor and Employee Relations Tracking System (“ALERTS”)²⁸ and the Problem Resolution Office Management Information System (“PROMIS”)²⁹ to produce responsive information. The IRS National Office noted in responding to the Joint Committee staff request that there is no one system, or combination of systems, by which the IRS can with certainty identify all instances in which an IRS employee may have been accused of exhibiting political or other bias or of otherwise interfering with cases involving tax-exempt organizations. The computer systems are not designed to track such information.

Since October 1, 1996 (in accordance with the Taxpayer Bill of Rights II), the IRS has had a Customer Feedback System. This system enables the IRS to record identified misconduct of IRS employees and is comprehensive enough to include instances in which an employee is accused of exhibiting political or other bias or otherwise interfering with cases involving tax-exempt organizations. This system may provide a systematic way for the IRS to track potential employee bias in the future; however, it was too new to provide any comprehensive or useful data with respect to cases involved in the Joint Committee staff investigation. The IRS checked the entries in this system from October 1, 1996, through May 27, 1997. For that period, the system recorded approximately 2,500 complaints, 14 of which applied to Employee Plans and Exempt Organization employees. These 14 cases were examined by the Joint Committee staff; one case involved an allegation relevant to the Joint Committee staff investigation, which was also disclosed in the survey of managers. The remaining cases concerned allegations of delays in case processing, failure to return calls or meet appointments, incompetence, or discourtesy.

²⁸ ALERTS is an IRS-wide automated case management and control system containing information about disciplinary cases, benefits and compensation cases, agency and negotiated grievances, inspection cases, negotiation issues, special projects and activities, third party appeals and adjudications, unfair labor charges and complaints, and centralized employee tax compliance cases. The ALERTS is currently the repository for information concerning employee misconduct. The ALERTS is maintained by the IRS Office of Labor Relations and provides data for reports and analyses of trends concerning the disposition of cases and the consistency of discipline. Cases in the ALERTS are coded to reflect the type of misconduct involved (e.g., absence without leave, insubordination, etc). Data concerning employee bias is not identified by a unique code and, therefore, not readily available from the ALERTS. From October 1, 1989 to May 30, 1997, on a nationwide basis, there were 309 entries on the ALERTS relating to Employee Plans and Exempt Organizations employees. No case was found in which the allegation of bias was present (one case involved an allegation of misuse of position against a neighbor).

²⁹ The PROMIS is used to control and process Problem Resolution Program and Taxpayer Assistance Order cases. Approximately 500,000 entries are prepared each year. The PROMIS system has no code used consistently to record an allegation of bias.

Due to the lack of a comprehensive data base or system for identifying all instances of allegations of political bias, the IRS National Office requested that managers in the IRS Key District Offices and the IRS National Office be surveyed to determine their recollections of such cases. The IRS requested information from the IRS Office of Executive Support, which is responsible for disciplining employees covered by the Executive Resources Board. This search revealed one instance relevant to the Joint Committee staff investigation, which was also identified through the Customer Feedback System.

The Joint Committee staff also reviewed personnel records of selected IRS employees, to the extent permitted under the Privacy Act.

Other material

Joint Committee staff reviewed all published and unpublished IRS documents from 1987 to the present relating to the standards for evaluating the political and lobbying activities of tax-exempt organizations described in Code sections 501(c)(3) and 501(c)(4), including standards for applying the private benefit test to such activities.

E. Review of Other Information

Affected organizations and individuals

The Joint Committee staff reviewed materials submitted to it by organizations and individuals.

Other investigations

The Joint Committee staff was given access to and reviewed all of the IRS Office of Inspection files relating to its investigation, including interview records and internal workpapers. In addition, Joint Committee staff requested and received copies of all Treasury Inspector General files relating to its investigation, including interview records and internal workpapers.

Other Federal agencies

The Joint Committee staff requested and received information from the White House, the Department of the Treasury, and the Department of Justice.

The Joint Committee staff requested that the White House, the Department of the Treasury, and the Department of Justice each provide all records of any communications (written, oral, or electronic) for the period 1990 to the present with the IRS that were initiated by the White House, the Department of the Treasury, or the Department of Justice regarding:

- general policies and practices of the IRS with respect to tax-exempt organizations (other than qualified pension plans described in section 401(a) of the Code), including the IRS's determination letter process and survey and examination process;
- the IRS's treatment of, or final determination regarding, any particular application for tax-exempt status submitted by any tax-exempt organization; and
- the initiation, conduct or resolution by the IRS of any survey for examination or examination of any particular tax-exempt organization or individual associated with such an organization.

The Joint Committee staff further requested of each office the applicable practice and procedure of such office for handling information submitted by third parties (both within and outside of the Administration, and including media reports) regarding the Federal tax status or affairs of organizations that are exempt from tax or are seeking tax-exempt status (as well as individuals associated with such organizations). The Joint Committee staff requested the policy and practice regarding involvement in the IRS determination letter and audit processes for tax-exempt organizations (including individuals associated with such organizations) by any employee of such office.

Because of the role of the Department of Justice in certain IRS litigation, the Joint Committee staff excluded from the scope of its request records of communications regarding matters in which Department of Justice involvement commenced only after completion of the IRS administrative process with respect to such matters. This was done to exclude routine communications relating to matters in litigation from the scope of the review.

The Joint Committee staff requested information from the White House Counsel's office of communications with the IRS or the Treasury Department by the White House with respect to tax-exempt organizations. The White House supplied correspondence tracking logs and copies of certain communications from taxpayers that were forwarded to the Treasury Department for routing to the IRS.

With respect to the request made to the White House, Senior Counsel to the White House Counsel conducted a search of White House files and found no White House correspondence with the Treasury Department or the IRS regarding tax-exempt organizations.³⁰ The search included the Oval Office, the office of the Chief of Staff (and the offices of the Deputy Chiefs of Staff and Senior Advisors to the President), the Office of Communications, the Counsel to the President, the Office of the First Lady, the Office of Legislative Affairs, the Office of Political Affairs, the Office of the Special Envoy for the Americas, the Staff Secretary, the Correspondence Office, Records Management, the Office of the Vice President, the Council of

³⁰ A similar search of Treasury Department and IRS employee files identified no correspondence written by White House employees relating to tax-exempt organization matters.

Economic Advisors, the Office of Management and Budget, the Domestic Policy Council, and the National Economic Council.³¹

The Joint Committee staff requested information on the extent to which the White House requested or received reports from the IRS on action taken with respect to information forwarded to the IRS from the White House.

The Joint Committee staff reviewed a printout of the correspondence log of tracked cases kept by the White House Office of Correspondence. There was no evidence from this correspondence log of any unusual handling of any correspondence relating to tax-exempt organization matters. In addition, the Joint Committee staff reviewed detailed information concerning certain letters to the White House on matters relating to tax-exempt organizations. None of these letters contained information relating to organizations that were relevant to the Joint Committee staff investigation.

³¹ With respect to employees who leave the White House, materials are sent to Records Management; this is also the practice for materials of current employees who need more space. Records Management inventories the name of each file received. In response to the Joint Committee staff document search, Records Management ran a computer search of file names and a manual search of file names not yet on computer, but did not find any information responsive to the Joint Committee staff request.

V. DETAILS OF IRS OPERATIONS RELATING TO EXEMPT ORGANIZATIONS

The allegations levied against the IRS charged that the treatment of tax-exempt organizations varied depending on the organization's perceived positions vis-a-vis the Clinton Administration and/or its policies. Tax-exempt organizations that were perceived to favor the Clinton Administration were alleged to have received favorable or expedited treatment, whereas tax-exempt organizations opposed to the Clinton Administration and/or its policies were alleged to have received unfavorable treatment.

As described in Part IV., to assess the validity of such allegations, the Joint Committee staff investigated the tax-exempt organization determination letter and examination processes in general. In addition, the Joint Committee staff reviewed complete case files and other information with respect to specific tax-exempt organizations (and individuals associated with such organizations) within the scope of the Joint Committee staff investigation.

An element of the allegations is the assertion that the IRS as an entity improperly reacted to information relating to tax-exempt organizations received from sources outside the IRS. To evaluate the merits of this assertion, the Joint Committee staff investigated not only the handling of such information items with respect to specific tax-exempt organization cases, but also the way in which such information reaches the IRS, the form such information takes, and the systems and controls the IRS has in place to process the information.

Another element of the allegations is the assertion that individual IRS employees and other Federal officials improperly influenced the outcome of specific tax-exempt organization cases. In this regard, the Joint Committee staff reviewed internal IRS controls relating to employee conduct, including applicable policies and procedures. The Joint Committee staff also reviewed IRS handling of actual allegations of employee misconduct with respect to tax-exempt organizations for the period 1990 through 1998.

The following discussion provides a detailed discussion of these critical elements of the Joint Committee investigation, including current IRS practices with respect to determination letters and examinations, IRS handling of information items, and employee conduct issues and procedures.

A. Determination Letter Process

1. General information relating to determination letter process

As discussed in Part IV., in the course of its investigation, Joint Committee staff requested and received from the IRS information relating to the handling of determination letter applications for tax-exempt organizations. Among the information provided by the IRS were

data relating to the determination letter process.³² The Joint Committee staff requested and received information on the number of determination letter applications for tax-exempt organizations received and IRS disposition of such applications for the fiscal year 1992-1996 period. In general, the IRS did not compile data on the determination letter process prior to fiscal year 1992 in a manner that could be readily retrieved. The Joint Committee staff requested specific information relating to organizations described in Code sections 501(c)(3) and 501(c)(4).

During the fiscal year 1992-1996 period, determination letter applications received by the IRS grew at a relatively constant rate. Table 1 provides statistics for this period on determination letter requests received, applications approved, applications withdrawn, applications closed for failure to establish tax-exempt status, and applications denied.

Table 1. -- Determination Letter Statistics Fiscal Years 1992-1999					
Fiscal Year	Applications Received	Applications Approved	Applications Denied	Applications Withdrawn	Applications Closed for Failure to Establish Exemption
1992	45,324	N/A ¹	N/A ¹	N/A ¹	N/A ¹
1993	61,306	46,166	696	1,512	8,864
1994	65,810	49,088	679	1,478	10,198
1995	67,178	50,613	619	1,468	11,442
1996	68,463	48,635	577	1,438	11,319
1997	77,733	52,776	299	1,358	14,000
1998	78,259	56,988	426	1,297	12,494
1999	74,444	58,160	470	1,244	9,186

¹ No data available prior to 7/15/93.

Approximately 70-75 percent of determination letter applications are approved annually. Fewer than one percent of the determination letter applications received are denied tax-exempt

³² These data were obtained from two management information systems. The Employee Plans and Exempt Organization Determination System (“EDS”) tracks determination letter applications that are processed at the IRS Key District Office level. The IRS National Office tracking system (“SEQUENT”) tracks information relating to determination letter requests that are either received or processed at the IRS National Office level.

status each year. The nine determination letter cases identified by the Joint Committee staff as within the scope of the Joint Committee staff investigation represent less than 1/100th of one percent of the applications received each year.

2. Overview of processing of determination letter applications

The Ohio Key District Office of the IRS is responsible for the processing of determination letter requests related to tax-exempt organizations. This process was centralized in the Ohio Key District Office, beginning on a phased-in basis in fiscal year 1996, to accomplish more uniform management and processing of applications for tax-exempt status. Applications are originally received in the Cincinnati Service Center, where they are input into the IRS's computer system and assigned a case grade.³³ The initial processing of requests (e.g., establishment on the Employee Plans and Exempt Organization Determination System ("EDS"), assignment of an EDS case number, and processing of user fees and technical screening) is centralized in the Ohio Key District Office. Cases are forwarded from the Service Center to the Ohio Key District Office Support and Processing Unit and held there until requested for technical screening. Cases not closed during technical screening are returned to the Support and Processing Unit and held as unassigned inventory until requested for assignment by the Ohio Key District Office groups or shipped to another IRS Key District Office. Cases to be processed by other IRS Key District Offices are shipped weekly.

Technical screeners review (1) the grade assigned to determination letter applications to ensure that the cases have been graded appropriately and (2) the application for completeness. The applications are then received by the processing staff, which consists of clerical employees who assign the determination letter requests to determination letter specialists. There are approximately 200 Exempt Organization determination letter specialists employed by the IRS.

IRS employees in the Ohio Key District Office fill out a sheet requesting cases to be processed. The cases are selected in date order. After signing for the cases, the employee begins screening for merit closures. This technical screening of determination letter requests is the inspection of the applications for the purpose of identifying and quickly approving applications from those types of organizations that have historically high levels of compliance with the Code and regulations.³⁴ During fiscal year 1995, 19 percent of all applications were closed after merit screening; in fiscal year 1996, 22 percent were so closed.

During the fiscal year 1996-1998 period, the processing and review of determination letter requests was in the process of being transferred to the Ohio Key District Office. During fiscal year 1996, only 18 percent of the determination letter requests received by the IRS for tax-

³³ In general, cases are graded either 9, 11, or 12 based on the complexity of the issues involved. The cases are then assigned to IRS employees based on the employee's grade level so that more difficult cases generally are not assigned to lower grade employees.

³⁴ IRM 7662.81(1).

exempt organizations were reviewed in the Ohio Key District Office and many of these were determination letter requests that were merit screened.

On average, the IRS processes determination letter applications that are merit screened in approximately 37 days, applications that are assigned for IRS Key District Office review in approximately 90 days, and applications that are forwarded to the IRS National Office in 190 days. The IRS monitors the average time taken to process determination letter cases and goals are established for these cases. For example, during fiscal year 1997, the goal for average time to process determination letter applications was 50 days in the case of merit screenings, and 87 days for all closures.

IRS employees prepare monthly time reports, which are used to highlight any problem cases and to explain any “old” cases. Employees must provide an explanation for any case over 100 days old that the employee has held for more than 35 days.

Pursuant to an IRS Field Directive dated January 21, 1999, if a determination letter application has been pending for 270 days or more, the taxpayer has the right to request a conference with the head of the appropriate division (i.e., the IRS Key District Director, if the case is in the Key District Office, or the Assistant Commissioner, if the case is in the IRS National Office) to discuss the status of the application.

An organization can request that the IRS expedite a determination letter application.³⁵ Under the Internal Revenue Manual,³⁶ requests for expedited treatment must be made in writing and contain a compelling reason why a case should be worked ahead of its normal date order. In general, expedited treatment is granted in the following circumstances:

- when a grant to the applicant is pending and the failure to secure the grant may have an adverse impact on the organization’s ability to continue operations;
- when the purpose of the newly created organization is to provide disaster relief to victims of emergencies such as flood and hurricane;
- when there have been undue delays in issuing a determination letter caused by problems within the IRS; and
- in any other situation where the Division Chief or his or her delegate feels expedited service is warranted.

The Internal Revenue Manual sets forth procedures for the handling of determination letter requests of tax-exempt organizations. The Internal Revenue Manual provides that each application for exemption should be screened and processed in the Service Unit within 10 working days after its receipt. Certain types of cases cannot be given favorable determination

³⁵ As described in Part IV.C., a high percentage of Congressional inquiries made with request to exempt organizations were requests to expedite the processing of determination letter requests.

³⁶ IRM 7661.2.

letters through the technical screening process;³⁷ included in this category of applications are cases involving Code sections the IRS deals with infrequently, cases with unusual issues, controversial types of organizations and cases with voluminous attachments. Determination letter applications in cases in which there may be an issue as to potential impermissible political and/or lobbying activities are not handled differently than other cases; such cases are not necessarily assigned a high grade. Cases that cannot be screened are assigned to a specialist to review. Determination letter case files are sent by grade level in chronological order to the determination letter groups on a work-needed basis. Neither IRS employees nor their group managers can choose the cases that are assigned to the employees.

The Internal Revenue Manual³⁸ states that IRS Key District Offices will issue determination letters as quickly as possible after completed applications and correct user fees are received. Cases are generally to be processed on a first-in, first-out basis. There is no specific criteria in the Internal Revenue Manual on the number of days to complete the processing of a determination letter application. However, the IRS National Office does issue an annual EP/EO Measurements Memorandum that includes calendar day measures for processing determination letter applications.

The IRS has an Exempt Organizations Application Worksheet (Form 6038) that was developed to ensure that uniform standards are applied to all tax-exempt organization determination applications. When issues are raised by a determination letter application, the Internal Revenue Manual provides the following guidance:

“Although an application for recognition of exemption may be ‘complete,’ (see Internal Revenue Manual 7662.6) additional information from the applicant may be required. EO personnel are urged to review carefully each application for exemption to ensure that requests for additional information are thorough, complete and relevant to the subsection of IRC 501(c) appropriate to the applicant. Improper determination letters often are issued in those cases in which organizations express their aims and purposes in broad, general language, usually tracking language used in the IRC or Regulations, without explaining the specific nature of the activities, the manner in which they will be conducted, or the source of income and nature of expenditures. . .

“Exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy these requirements. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures,

³⁷ IRM 7662.81.

³⁸ IRM 7661.1(12).

or other means adopted or planned for carrying out the activities; the anticipated sources of receipts; and the nature of contemplated expenditures.”³⁹

Under the Internal Revenue Manual, if an application is complete but additional information is needed, a letter is sent to the applicant requesting that such information be provided within 21 days. The Internal Revenue Manual also states that it may be helpful to contact applicants by telephone to clarify information on the determination letter application prior to issuing a letter requesting additional information from the organization. However, the Internal Revenue Manual provides that, if the question concerns inurement, discrimination, political activity, or anything else that is a deciding factor for tax-exempt status, the information must be obtained in writing over the signature of an officer or authorized representative of the organization.⁴⁰

Under the Internal Revenue Manual, if requested information is not received within the 21-day period, then the IRS employee is directed to attempt to telephone the individual whose name and phone number appears on the application, or the organization’s authorized representative, to inquire about the status of the requested information. If the information is not received within 35 days and there has not been a written or oral request for an extension, then the Internal Revenue Manual provides that the case will be closed as Failure to Establish (“FTE”) Exempt Status. The organization is advised by letter that the IRS has closed the case.

In general, the IRS is required to accept the statements made on a determination letter application as true. If, however, the IRS has information indicating that the organization may operate or is operating in a manner that is contradictory to the statements made on the face of the application, the taxpayer is given the information and asked to comment on it. If the organization is operational, the IRS may initiate an examination of the organization’s activities prior to issuance of a determination letter. In addition, the IRS employee who is reviewing the application may complete an information referral (Form 5666 -- EP/EO Referral/Information Report), which is placed in a future action file in the relevant IRS Key District Office. Prior to 1998, there was no systematic method by which these information referrals were handled. As of February 25, 1998, the Ohio Key District Office had begun using a tracking system to follow these information referrals.

IRS employees interviewed by the Joint Committee staff indicated that many organizations requesting tax-exempt status are small and relatively unsophisticated; often the determination letter applications will not contain information that adequately establishes that the organization will be operated in a manner that justifies tax exemption. IRS employees believe that this lack of expertise necessitates more assistance on the part of the IRS than might be necessary in other areas. The IRS will generally try to assist organizations in perfecting their

³⁹ IRM 7665.3.

⁴⁰ IRM 7665.3(9).

determination letter applications so that a favorable letter may be issued. This educational process can lead to delays in the processing of determination letter applications.

The IRS has discretionary authority to issue determination letters. The IRS may refuse to rule or may issue an adverse ruling. The organization may also withdraw its application at any time prior to the issuance of a proposed denial of the application for exemption. IRS employees may not solicit the withdrawal of determination letter applications.⁴¹

Proposed adverse rulings and determination letters are required to contain the following information: (1) a statement of the material facts upon which the determination is based; (2) the applicable statute, regulations, or other governing precedent; and (3) the conclusion and a clear explanation of supporting reasoning. The letter must explain the organization's right to protest to the IRS Appeals Division, the organization's right to a conference, and, in cases involving Code section 501(c)(3), that appropriate State officials will be advised of the action under Code section 6104(c). If the organization's request for exemption is denied, the IRS employee will request that the organization furnish the appropriate tax returns as a taxable entity. In addition, the IRS employee will prepare Form 5666 and make a referral to the Examination Division.

Under section 7428, once an organization's administrative remedies have been exhausted, the organization may request declaratory judgment upon the IRS's refusal to rule or adverse ruling.

3. Internal review of determination letter processing

Within the Ohio Key District Office, a Review Staff is responsible for reviewing determination letter cases and providing technical assistance to IRS employees who process determination letter cases. Review Staff employees are generally selected from experienced employees and receive considerable on-the-job training in the review function.

The Internal Revenue Manual (and local procedures) provide that certain determination letter cases are subject to mandatory review by the Review Staff.⁴² Among the types of cases for which mandatory review is required are (1) impact cases (controversial issues involved, issues involving regional or national impact, or issues that may cause widespread publicity for the IRS), (2) technical advice cases, and (3) proposed adverse determinations for organizations seeking tax-exempt status under section 501(c)(3). In all, there are approximately 20 types of cases that are subject to mandatory review.

In addition to the mandatory review cases, other cases may be forwarded to the Review Staff as part of the Employee Plans and Exempt Organization Quality Measurement System ("EQMS"). Under EQMS, a Review Staff employee completes a check list based on a review of

⁴¹ IRM 7665.2.

⁴² IRM 7(11)21.2.

a statistical sample of determination letter cases. The completed check list is used to generate reports that measure work quality. EQMS results for the Ohio Key District Office for the last quarter of fiscal year 1996 showed that, of 364 determination letter cases reviewed by the Review Staff, 13 (3.6 percent) were returned to the group (i.e., sent back to the employee handling the determination letter request) because of errors identified in the handling of the case. For non-EQMS cases for the same period, of 91 cases reviewed, 8 (8.7 percent) were returned to the group. EQMS generates trend reports and error reports periodically.

The Review Staff does not track errors by employee for EQMS purposes. However, with respect to mandatory reviews, the Review Staff does track errors by employee and retains copies of the reviewer memoranda.

In the event of a disagreement between the Review Staff and an employee as to the nature of an organization's activities, then the approach generally taken is to ask the organization to provide additional documentation to support the organization's application.

Quality in examination cases is measured in terms of seven different standards. These standards include (1) hours charged to the case, (2) time taken to complete the case, (3) contact frequency, (4) technical quality of the case, (5) administrative aspects of the case, (such as preparation of forms and workpapers), (6) taxpayer communication, and (7) manager rating.

The Review Staff issues periodic review bulletins to group managers in the event of persistent problems or recurring issues.

4. IRS National Office involvement with respect to determination letter requests

Under current IRS procedures, the IRS National Office processes certain determination letter requests. In general, under Delegation Order 113, Key District Office Directors are authorized to issue, modify, or revoke determination letters under sections 501 and 521 of the Code. However, the Internal Revenue Manual provides that the following determination letter cases are to be forwarded to the IRS National Office for processing: (1) applications that present questions for which there is no clear established guidance; or (2) applications that have been specifically reserved by revenue procedure and/or Internal Revenue Manual instructions for IRS National Office handling.⁴³ The Internal Revenue Manual provides that once a case has been identified for IRS National Office handling, it must be expedited by Key District Office personnel to avoid delays in issuance of the determination letter that may cause taxpayer complaints.

When a determination letter application is referred to the IRS National Office, it is removed from the EDS database and input into the IRS National Office database, which is referred to as SEQUENT. IRS National Office personnel are generally more experienced than their Key District Office counterparts.

⁴³ IRM 7664.1.

The procedures for processing determination letter applications in the IRS National Office are the same as those followed by the Key District Offices. Each application receives a control number and is reviewed to determine if the proper user fee was submitted. Applications are entered into the IRS National Office database (SEQUENT) and assigned to a branch. The application is reviewed by the Branch Chief (and the Division Chief in some cases). Branch Chiefs track the progress of cases through reports that include the assignment date, status, total hours charged, and age. The Assistant Commissioner's office is informed when cases are considered sensitive through the Report of Significant Matter in EP/EO. Unlike the Key District Offices, the IRS National Office has a 100-percent review rate for all determination letter applications processed.

The IRS National Office receives approximately 2,000 of the approximately 70,000 determination letter applications filed each year. In fiscal year 1996, the IRS National Office closed on merit 268 applications, approved 1,570 applications, and denied tax-exempt status in 158 cases.

The IRS National Office conducts a limited post-review function with respect to determination letter applications reviewed in the Key District Offices; in these cases the IRS National Office reviews determination letter cases after the determination letter has been issued. This post-review function was reduced in 1992 and was limited to cases involving private schools. In 1998, the post-review process was reinstated using a sample procedure. The post-review function can lead to an audit of the organization.

Some IRS employees believe that the process of referring determination letter cases to the IRS National Office is in need of reform. One IRS employee stated that the Office of Chief Counsel's concern about losing court cases resulted in a lack of clarity with respect to applicable standards for referral.

5. Training of IRS employees with respect to processing of determination letter requests

IRS employees are provided training with respect to the handling of tax-exempt organization determination letter requests. New employees undergo specific training programs. These programs consist of the following: (1) a 10-day classroom course that provides employees with a basic understanding of what to expect on the job and what is expected of them (the EP/EO New Employee Orientation); (2) a 20-day classroom course that is a comprehensive study of Federal tax laws relating to exempt organizations (EO Tax Law); and (3) five weeks of on-the-job training. In addition, new employees are given a 15-day Basic Income Tax Training for EP/EO, which is a condensed version of the revenue agent training program, and a 10-day Auditing Techniques course.

All IRS tax-exempt organization specialists receive continuing professional education ("CPE") training annually. IRS employees interviewed by the Joint Committee staff generally indicated that the CPE training materials were very good to excellent. Some IRS employees interviewed suggested that more CPE training would be useful and that more specialization in

particular issues would be desirable. Some IRS employees complained about not having access to basic research tools, such as Lexis or Westlaw, and not being able to get their own copy of the Internal Revenue Code or, if they did get one, it was an out-of-date version.

B. Examination Process

1. Tax-exempt organization examination function

Four IRS Key District Offices currently conduct tax-exempt organizations examinations - Northeast, Southeast, Western, and Midstates. Although the IRS National Office has programmatic authority over the Employee Plans and Exempt Organization Key District Offices, it has no direct line authority. Such line authority is exercised by the regions in which the IRS Key District Offices are located.⁴⁴

For 1993-1995, the Exempt Organization Division budgeted an average of approximately 26 percent of available staff days to its examination program. The IRS currently employs approximately 400 revenue agents to conduct examinations of tax-exempt organizations. Table 2 shows the breakdown of Exempt Organization Field Exam staff to total Exempt Organization staff for fiscal years 1990-1997.

Table 2.—IRS Exempt Organization Field Exam and Total Exempt Organization Staff, 1990-1999

Fiscal Year	EO Field Exam Staff	Total EO Staff¹
1990	374	862
1991	348	851
1992	356	868
1993	354	863
1994	375	860
1995	427	946
1996	439	958
1997	411	924
1998	395	891
1999	390	895

¹ Includes all IRS Key District Office and IRS National Office staff.

As of January 1, 1997, the IRS had 8,790 open tax-exempt organizations examinations -- 1,966 of these related to section 501(c)(3) organizations and 422 related to section 501(c)(4)

⁴⁴ See discussion in Appendix A, below, above, regarding prior experiments within the Exempt Organization Division to revise the chain of command and the revised structure to be implemented as part of Commissioner Rossotti's restructuring plan for the IRS. The discussion herein is based on the chain of command as it existed in 1997 and 1998.

organizations.⁴⁵ Because approximately 30 percent of all tax-exempt organizations are within the Southeast Key District Office's jurisdiction, a significant portion of examination activity is performed within that IRS Key District Office. Table 3 shows the number of active tax-exempt organizations and returns examined for fiscal years 1993-1999.

Table 3.--Examinations of Tax-Exempt Organizations, 1993-1999

Fiscal Year	Active Exempt Organizations¹	Total Returns Examined (Excluding Tax-Exempt Bonds)
1993	1,103,265	12,589
1994	1,126,976	11,765
1995	1,149,867	10,450
1996	1,187,700	10,952
1997	1,235,470	10,600
1998	1,285,663	10,227
1999	1,316,878	8,519

Source: Internal Revenue Service

¹ Number of active tax-exempt organizations does not include churches that have not elected to file with the IRS.

On average, the IRS audits approximately 0.7 percent of tax-exempt organization returns annually.

2. Selection of tax-exempt organization returns for examination

In general

The IRS tax-exempt organization function selects tax-exempt organization returns for examination in a variety of ways. Although the IRS National Office does not exercise line authority over the IRS Key District Offices, it does establish general work priorities through the IRS National Office Workplan Guidelines. These guidelines set the general parameters for what each IRS Key District Office is expected to accomplish for the upcoming fiscal year with respect to, among other items, examination coverage. For fiscal year 1997, the breakdown of examination time provided in the IRS National Office workplan to the District Offices was 30 percent for coordinated examination program cases, 7-9 percent for tax-exempt bonds, 5 percent for gaming, 5-15 percent for headquarters (nationwide) projects, and the remaining approximately 42-54 percent reserved for local projects and case work.

⁴⁵ As of June, 1993, Employee Plans and Exempt Organizations assumed responsibility for tax-exempt bond financing. The tax-exempt bond audit program is separate from the regular exempt organization audit program.

Coordinated Examination Program (“CEP”)

To supplement its regular examination program and in acknowledgment of the increasingly complex structures of tax-exempt organizations, the Exempt Organization Division initiated the Coordinated Examination Program (“CEP”) in August, 1991. Prior to this time, examinations of larger tax-exempt organizations were limited to reviewing the organization’s activities and verifying the accuracy of return information. The CEP procedures contemplate that the examination will be conducted by a team of experienced agents, headed by a case manager.

A tax-exempt organization can be included as a CEP case if it is a domestic or foreign organization together with effectively controlled entities (regardless of the percentage of ownership) whose organizational structure, geographical dispersion, or other examination problems warrant application of coordinated case procedures.⁴⁶ These examinations may require interdistrict coordination (because of the geographical dispersion of related organizations), team audit techniques, and case manager participation. Churches are not included in the universe of organizations that may be identified for CEP audit.

Factors that are taken into account in identifying CEP cases are total assets of the organization, gross receipts, controlled and/or related entities, national impact, team members, specialists, support employees, and total direct examination staff days. Under current IRS procedures, the following organizations may be considered for a coordinated examination: (1) organizations with assets or income of \$50 million or more and with related taxable and/or tax-exempt entities; (2) organizations with controlled or related entities whose total combined assets and/or income exceed \$50 million; (3) EP/EO Industry Specialization Program issues; (4) evangelist organizations which use the radio and television media; (5) multi-organizational health care organizations; (6) central or parent organizations (generally State, regional, or national organization) with one or more subordinate or otherwise related organizations; (7) colleges and universities with multiple operations (i.e., hospitals, TV stations, radio stations, hotels, publishing activities, national testing services); and (8) any other case which would materially benefit from the greater involvement of a manager and a team examination approach.

As part of the IRS Key District Office’s program planning for the CEP, the Key District Office must identify its CEP universe, which is a list of the organizations in the Key District Office’s jurisdiction that are candidates for a CEP audit. In general, the CEP audits that are commenced in any fiscal year will be drawn from the IRS Key District Office’s list of CEP organizations in a manner consistent with the goals of the IRS National Office work plan.

Approximately 22 percent of direct examination time was devoted to CEP audits during fiscal year 1993. The percentage increased to 32 percent in fiscal year 1995, and was 30.7 percent for fiscal year 1997. The number of CEP returns examined and closed increased from 157 during fiscal year 1993 to 655 during fiscal year 1995. The amount of additional taxes and penalties assessed also increased from \$6.4 million to \$40.0 million. One half of CEP exams are

⁴⁶ IRM 7(10)(18)4.1.

hospitals and one quarter are colleges and universities. The remaining one quarter include a variety of other organizations.

IRS National Office projects/samples

In general.--In its annual Workplan Guidelines, the IRS National Office identifies certain types of organizations or activities that may warrant examination. In certain cases, the IRS National Office projects consist of gathering information about certain types of entities to determine patterns of potential noncompliance. In other cases, based on such information gathering projects, the IRS National Office may identify certain issues for examination focus. In every case, however, the IRS National Office Workplan identifies categories of returns, rather than specific organizations. In addition, the IRS Key District Offices generally are not mandated to carry out the projects, but rather are directed to consider incorporating them into the examination plan.

There are both mandatory nationwide projects (the IRS Key District Offices are required to do them so that a valid statistical sample is achieved) and discretionary projects. The IRS National Office may provide names of taxpayers to the Key District Offices by doing a computer run of organizations in the project universe. Thus, organization names may be attached to the samples in some cases.

Political and lobbying activities.--Certain of the IRS National Office Workplans described projects involving the political or lobbying activities of tax-exempt organizations. For example, the 1990 Compliance Workplan noted that a special emphasis examination program on the political and legislative activities of section 501(c)(3) public charities and section 501(c)(4) social welfare organizations commenced in fiscal year 1988 and continued in fiscal year 1989. The program involved the completion of a lobbying and political expense checksheet in connection with the examination of every section 501(c)(3) and section 501(c)(4) organization. As of April, 1989, the IRS had collected 1,710 checksheets on section 501(c)(3) organizations and 334 checksheets on section 501(c)(4) organizations. Of these, approximately 1 percent had made the lobbying election under section 501(h). In the course of the examinations, no organization's tax exemption was revoked because of excessive lobbying. The IRS National Office noted that two regions recommended that this program be eliminated in fiscal year 1990 because of the small number of organizations engaged in lobbying and political activity. However, it further noted that Congress was concerned that the IRS have some type of program in this area. Accordingly, the IRS National Office directed that the information gathering program would continue in fiscal year 1990 with respect to section 501(c)(3) organizations that are found to be engaged in lobbying or political activity, but not with respect to examinations of section 501(c)(4) organizations. The program also continued into fiscal year 1991 "in view of continuing congressional oversight interest."⁴⁷

⁴⁷ Fiscal Year 1991 Employee Plans and Exempt Organizations Workplan.

In addition, the 1990 and 1991 Compliance Workplans stated that, in fiscal year 1988, all political action committees (“PACs”) came under the jurisdiction of IRS Employee Plans and Exempt Organizations. Due to the relative inexperience of the division in this area and the continuing interest of Congress and others in these types of activities, the IRS National Office suggested that the IRS Key District Offices might consider examination of some PACs in the development of their workplans.⁴⁸ The objective was to gain information and experience to aid in the future planning and conduct of examinations in this area. The 1992 Compliance Workplan contained a more specific directive, stating that each IRS Key District Office should examine at least ten PACs during fiscal year 1992. The IRS National Office noted that “since 1990 was an election year, you should give priority to initiating examinations for that year,” and suggested review of State election commission filing and other sources, such as media coverage, to identify potential noncompliance.

In the IRS Fiscal Year 1993 Workplan, issued by the IRS National Office in June, 1992, political activities was an IRS National Office-designated compliance priority. The objective of the project was to “ensure that organizations exempt under sections 501(c) and 527 are in conformance with the statutory requirements. Since 1992 is an election year there should be a particular awareness of, and a focus on, the political activities of section 501(c)(3) organizations and political organizations under section 527.” The objectives emphasized that “educating organizations about the restrictions on engaging in political activities and the filing requirements of Form 1120 POL should increase voluntary compliance since many of the noncompliant organizations are not aware of the requirements. We are encouraging the use of non-examination compliance initiatives to address these issues.”

The IRS Fiscal Year 1997 Workplan issued by the IRS National Office in June, 1996, noted that “during the election cycle of 1994 to 1996, numerous news articles were published concerning exempt organizations’ intervention in political activities and their increased electioneering efforts. Therefore, the regions should consider developing and implementing local projects in this area, as well as addressing specific situations of potential noncompliance.”

Market segmentation projects.--During fiscal year 1994, the IRS implemented a so-called “market segmentation” program that attempts to identify areas of noncompliance within certain segments of the tax-exempt organization community. Time budgeted to these special projects decreased from 14.4 percent of total examination time in fiscal year 1994 to 9.7 percent in fiscal year 1996.

Local projects

Local projects are projects developed by the IRS Key District Offices, and generally arise out of the particular characteristics of the filing population served by the IRS Key District Office, although they may have wider applicability. The Joint Committee staff reviewed 80 local

⁴⁸ In this case, the proposed examination activity was discretionary and the IRS National Office did not prepare a sample of specific organizations to be considered.

projects undertaken during the period of 1990-1997. Of these 80, only one local project related even tangentially to the political activities of tax-exempt organizations. The purpose of the project was to determine why organizations that have political expenditures do not file a Form 1120 POL so that the IRS could implement appropriate education initiatives to improve compliance. The IRS Key District Office expected the majority of organizations in the sample universe for such project to be organizations described in Code sections 501(c)(5) and 501(c)(6).

Other procedures for classification and selection of tax-exempt organization returns for examination

As discussed above, the annual IRS National Office workplan sets forth an expected allocation of time among various general activities and projects. To accomplish those goals, each IRS Key District Office is responsible for identifying taxpayers and returns for audit. If an IRS Key District Office was required to allocate a percentage of time to a specified IRS National Office project, selection of the tax-exempt organizations to be included in the project generally would be performed at the Key District Office level. As discussed below, other factors that must be taken into account in determining examination coverage include case group workload and geographic coverage.

Computer identification

In the past, the IRS relied primarily on a computerized mathematical technique known as SERFE (Selection of Exempt Returns for Examination) for selecting returns for examination.⁴⁹ Under SERFE, returns were scored by assigning weights to certain basic return characteristics. However, the information used to develop the scoring formulas was derived from taxpayer compliance management program (“TCMP”) examinations conducted over twenty years ago. Therefore, its utility as a return selection mechanism was minimal. For example, during fiscal years 1993-1995, 65 percent of tax-exempt organization returns selected for examination were selected by SERFE. However, 64 percent of such returns were closed as non-examined. Almost 75 percent of the non-examined returns were closed for lack of audit potential. At present, SERFE is used primarily for selecting cases for examination when a particular case grade or location is important.⁵⁰

In an effort to improve its return selection process, the Exempt Organization Division implemented the Return Inventory Classification System (“RICS”) beginning in 1996. This system permits searches for returns based on a variety of criteria, including size, location, and type of tax-exempt organization. It also retains data over multiple years, thus permitting comparative analyses.

⁴⁹ See IRM 7922, 7923.

⁵⁰ SERFE might be used, for example, if a KDO needed a certain number of GS-11 cases for its inventory.

RICS selects returns from the EOMF (Exempt Organizations Master File), which is a subset of the IRS Business Master File. However, only about 20 percent of tax-exempt organization return data is key punched and, therefore, included in the EOMF.

A selection of a return for examination based on return information only is inherently incomplete. An internal IRS review of tax-exempt organization return selection conducted in 1991 noted that a classification system based on return information can only identify potential issues that appear on the return. Many tax-exempt organization issues deal with an organization's activities and are not particularly susceptible to the use of computerized classification methods. Many such issues are not apparent even from a manual review of the return. In addition, tax-exempt organizations are more likely to file inaccurate or incomplete returns. The IRS review stressed the necessity of retaining some kind of random examination program.

Manual identification⁵¹

In general--Manual identification of returns involves review by the Returns Program Manager ("RPM") of information items received by an IRS Key District Office from various sources.⁵² The items are screened for merit and the applicable return may be requested and reviewed. Returns that are deemed to have audit potential based on this review are forwarded to groups. The Group Manager and then an assigned employee review the returns as well. At any point in the process, returns may be "screened;" i.e., closed without an examination. This may occur because the return does not appear to have audit potential or because of workload constraints.

Particularly in the tax-exempt organization area, information items play a role in the examination selection process.⁵³ In a 1997 memo, the Southeast Key District Director noted that the Southeast Key District Office "continues to generate a significant part of its tax-exempt organization examination workload from information referrals....generated by news media, Members of Congress, State and local governmental officials, concerned third parties in the tax-exempt organization community, and Service personnel." In some cases, such as churches which are not required to file returns, referrals may constitute the only way in which a tax-exempt organization comes to the attention of the IRS. The Joint Committee staff investigation identified that examinations initiated by such referrals comprise less than 10 percent of tax-exempt organization examinations each year.

The various sources of information items reviewed by the Returns Program Manager, as well as the handling of such items in each of the IRS Key District Offices, is described below.

⁵¹ See, also, the discussion in Part V.C.

⁵² IRM 7917.2.

⁵³ See the definition of information items in Part V.C.

Referrals from within the IRS.--Within the IRS, there is a well-established system whereby employees in one part of the IRS who identify potential tax enforcement issues that are outside of their jurisdiction can refer such issues to the appropriate IRS office. Employee plans and tax-exempt organization issues are reported on Form 5666 (EP/EO Information Report) or Form 5346 (Examination Information Report).⁵⁴ For example, a determination letter specialist who approves the tax-exempt status of an organization based on the record before him or her, but who believes there is an issue as to how the organization will actually operate, can complete a Form 5666 recommending an examination to occur at a later date. This form would be forwarded to the IRS Key District Office with examination jurisdiction over the entity in question. Returns Program Managers are required to ensure that Forms 5666 are promptly screened.⁵⁵ Those Forms 5666 that the Returns Program Managers concludes do not warrant ordering a return for examination are so annotated and closed during the screening process.

The Joint Committee staff found that Forms 5666 are consistently a good source of referrals. A 1991 internal study consistently showed a close to 100-percent change rate on examinations resulting from referrals from employee plans and tax-exempt organization examiners. The report concluded that the proper use of Form 5666 can significantly improve the return selection process. One Chief of the Returns Program Manager section stated that most referrals come from other functions within the IRS; on rare occasions referrals are received directly from a taxpayer.

Referrals from the IRS National Office.--The Internal Revenue Manual requires copies of ruling letters and information items received from the IRS National Office to be screened at least monthly.⁵⁶ Those that are not deemed to warrant examination should be noted and filed in the administrative file maintained regarding the organization. If a return is requested, the information item is to be attached to the return for reference during the examination. During the fiscal year 1995-96 period, in the Southeast Key District Office, a total of 43 returns were closed with an IRS National Office referral source code. This number represents 1.3 percent of total closures for the Key District Office.

During the late 1980s, a reporting structure was instituted whereby the IRS Key District Offices reported the disposition of IRS National Office referrals back to the IRS National Office. Due to concerns and complaints from IRS Key District Offices about the appropriateness of such reporting, the reporting requirement was eliminated beginning in fiscal year 1992.

Third-party referrals.--The IRS routinely receives referrals from third party sources. These take many different forms and often different routes to the IRS. In many cases, taxpayers write to the IRS and provide information regarding an organization or individual that they believe

⁵⁴ IRM 7917.1.

⁵⁵ IRM 7916.

⁵⁶ IRM 7918.

warrants further investigation by the IRS. In other cases, taxpayers may write to their Congressman or to the President, who, in turn, forward the information to the IRS. The manner in which the IRS processes such correspondence is discussed in further detail in Part V.C.

Another important third party source of information regarding taxpayer activities is the media. Reliance on media articles as a source of information regarding potential areas of noncompliance is not a new phenomenon. For example, the IRS National Office FY 1990 Workplan specifically states that one measure to be taken into account in identifying organizations most in need of examination is periodic reviews of media sources to identify potential areas of noncompliance.⁵⁷ To this end, a 1991 IRS internal study recommended improved access to Federal Election Commission data and recommended funding for an inexpensive clipping service for newspaper articles. The IRS National Office FY 1992 Workplan generally stressed identification of noncompliance areas through such resources as informational referrals from the public, other IRS functional areas, media coverage, and condition codes. The IRS National Office FY 1993 Workplan also noted that Key District Offices should use news reports and information referrals as potential sources of information for locally identified initiatives.

In general, referrals constitute a minority of time spent on examinations, and third party referrals an even smaller percentage of the case load. Less than 8 percent of roughly 5,600 organizations under examination in 1997 involved referrals from any source, including IRS internal referrals and other government agency referrals. In 1996, 5,800 cases were closed; of those, 612 (11 percent) resulted from referrals from all sources (approximately one half of referrals came from the determination letter process).

3. Internal Revenue Manual procedures for classification and selection of returns

In general

The returns classification program generally is under the supervision of the Chief of the Employee Plans and Exempt Organization Division in each IRS Key District Office. Each Employee Plans and Exempt Organization Division Key District Office is required to establish and maintain a quality classification review system to make certain that the returns disclosing the greatest need of examination are selected for assignment to the examination groups.⁵⁸

⁵⁷ Other measures included participation in multi-functional and inter-governmental investigations and examinations, and identification of organizations in need of examination during determination letter processing.

⁵⁸ IRM 7913.2.

Each IRS Key District Office prepares a classification plan annually in accordance with the guidelines and objectives identified in the application of the fiscal year workplan.⁵⁹ The plan must ensure that each group has an adequate case load within the constraints of geographic limitations and case grade.⁶⁰ Overall, in determining the number of returns to be classified in any given year, the Returns Program Manager must consider the number of returns to be examined within the various types and sources, inventory on hand, actual selection rate experience, overselection needed to provide geographical coverage, and to permit surveys of less productive returns, returns from other sources (claims, referrals, pickups), etc.⁶¹ The Returns Program Manager also must monitor returns in inventory to ensure that there is an adequate supply to satisfy current and anticipated needs.⁶²

The Returns Program Manager is only the first step in the selection process at the IRS Key District Office level. Returns selected by the classifier are distributed out to groups dispersed geographically through the region. Based on the classification plan, workload and case grade requirements, group managers identify cases for assignment to the revenue agents in their group. Both group managers and revenue agents have the authority to “survey” a return -- that is, close it without an audit -- if they determine that it does not have adequate audit potential. An agent or group manager may be required to explain why a particular return was surveyed, but they retain absolute authority to do so. Thus, the examination process is decentralized; the authority to initiate and conduct examinations rests with IRS career employees located in IRS Key District Offices throughout the country.

With the exception of collateral or related exams, revenue agents cannot initiate examination on returns that have not been identified through the classification process. Thus, if an IRS employee identifies a tax-exempt organization or individual return that may warrant examination, the employee would complete a referral form and the referral would work its way through the classification process. The examination would not be assigned to the IRS employee who initially made the referral.

Returns Program Managers

The Returns Program Manager manages the classification program. Each IRS Key District Office must select classifiers with a wide range of expertise in the examination of

⁵⁹ IRM 7952.1.

⁶⁰ Returns selected are generally assigned by grade. Some returns have an assigned grade; for others, a grade is assigned by the RPM. IRM 7943.1. Gross receipts and assets are the primary factor in assigning case grade, but other factors play a part as well.

⁶¹ IRM 7952.2.

⁶² IRM 7953.3.

returns.⁶³ The Joint Committee staff found that each IRS Key District Office made an effort to rotate individuals through the classifier program.

IRS Key District Offices are required to select the most technically proficient specialists for manual classification and screening to ensure that the classifier has the skills, technical expertise, knowledge, and experience to recognize hidden as well as obvious issues.⁶⁴ Among the factors to be considered in reviewing the performance of a Returns Program Manager are whether classifiers (1) treat return issues consistently and (2) remain alert for patterns of problem returns or possible abuse situations.⁶⁵

Return selection process

Returns Program Managers select returns using a variety of different methods, including computer or manual identification. Computer identification includes using SERFE or RICS. Manual identification includes returns identified by information items, examination referrals or referrals from other Federal agencies. All returns must be manually classified or screened.⁶⁶ Accordingly, returns selected by computer classification must then be manually screened to determine those which warrant examination.

Several “high interest” areas for selecting tax-exempt organization returns for examination are listed in the Internal Revenue Manual.⁶⁷ With respect to political and lobbying activities, the Internal Revenue Manual states that “particular attention, especially in election years, should be given these returns and the extent that political and lobbying activities appear greater than usual.” In addition, the Internal Revenue Manual states that, in the examination of a section 501(c) organization, particular emphasis should be placed upon the political activities of the organization. For example, the Internal Revenue Manual states that IRS employees should determine if Form 1120-POL has been filed, if required.

Handling of information referrals

The Internal Revenue Manual requires the IRS to retain records to measure classification program accomplishments.⁶⁸ A record-keeping system sufficient to provide information on all

⁶³ IRM 7913.2.

⁶⁴ IRM 7942.

⁶⁵ IRM 7955.

⁶⁶ IRM 7915 (Methods of Selection).

⁶⁷ IRM Exhibit 7910-1.

⁶⁸ IRM 7913.2.

referrals and to determine the location and disposition of them must be maintained.⁶⁹ Forms 5666 relating to returns with no audit potential may be screened out and destroyed.⁷⁰ However, a recordkeeping system must be maintained which provides an explanation for why a referral is screened out. Information reports or referrals with good examination potential which are screened due to excessive workload or require future action should be maintained in an enforcement follow-up file by the Returns Program Manager or designee.

In 1990, in response to the IRS's inability to answer Congressional inquiries as to the disposition of materials provided regarding inappropriate activities of an exempt organization, the IRS National Office issued a memo instructing the Key District Offices to provide information on the disposition of all referrals that required a written response. These procedures were followed until 1994. Modified procedures, described in Part V.C., now require the tracking of the disposition of referrals.

Examination process

After a return is selected for examination, a revenue agent commences the examination by contacting the taxpayer. Both the Internal Revenue Manual and the IRS training manual state that IRS employees should explain the examination process to taxpayers at the initial interview. Included with the initial letter is a copy of Publication 1 - Your Rights as a Taxpayer.⁷¹ Until fairly recently, IRS employees in the tax-exempt organization area generally were told in training to be honest, but to avoid volunteering information as to why a particular taxpayer is under examination. However, the Joint Committee staff found that IRS procedures appear to be changing. One IRS Exempt Organization Group Manager indicated that he is now instructing his employees to be more open with taxpayers regarding the reason for the examination (i.e., tell them if the examination was started because of a news article or complaint without identifying the complainant).

With regard to the scope of a tax-exempt organization examination, normally an IRS employee is expected to pursue the examination to a point at which he or she can, with

⁶⁹ IRM 7916.

⁷⁰ IRM 7916.

⁷¹ IRM 7(10)00 Examination Procedures. The Internal Revenue Service Restructuring and Reform Act of 1998 required the IRS to add to Publication 1 a statement which sets forth in simple and nontechnical terms the criteria and procedures for selecting taxpayers for examination. The statement must specify the general procedures used by the IRS, including whether taxpayers are selected for examination on the basis of information in the media or from informants.

reasonable certainty, conclude that all items necessary for a proper determination of tax-exempt status have been considered.⁷²

4. Internal review of examinations

Under general procedures for review of examination cases, all completed case files go through the Group Manager before closing and computations are verified.

Certain examination cases are selected for review by the Technical/Review staff. The Review staff are experienced revenue agents who are selected to perform case reviews for a period of 18 months to 3 years. An Exempt Organization reviewer is responsible for measuring and reporting on the quality of the work of tax-exempt organization revenue agents and group managers, as well as for efforts to improve the quality of the work of the tax-exempt organization groups. The reviewers conduct training sessions for employees and group managers, prepare memoranda on cases, and generally try to identify emerging issues of importance to the exempt organization groups.

The reviewer's work with respect to quality control takes two forms. First, under EQMS, the reviewer completes a check sheet based on a review of a statistically valid sample of cases.

The second category of cases are those cases subject to mandatory review. There are approximately 20 types of cases identified in the Internal Revenue Manual and in local procedures that are subject to mandatory review. Among the types of cases designated for mandatory review are proposed revocation or modification of tax-exempt status for an organization described in section 501(c)(3), cases involving final revocation for other than a section 501(c)(3) organization, and technical advice cases. With respect to these cases, the Exempt Organization reviewer writes up managerial memoranda that are sent to the Revenue Agent, the Group Manager, and the Division Chief. Such cases may be returned to the Revenue Agents for additional work if the reviewer deems it necessary.

5. IRS National Office involvement in the handling of examinations relating to specific taxpayers

In general

Because it has no direct line authority over the IRS Key District Offices, the IRS National Office cannot direct an IRS Key District Office to initiate an examination of a specific taxpayer. The IRS National Office does influence the examination workload of the IRS Key District Offices through the annual work plan.

In addition, the IRS National Office forwards to the IRS Key District Offices information items that come to the attention of IRS National Office personnel. These information items will

⁷² IRM 7(10)00.

be in the form of media reports, Congressional inquiries, referrals from other agencies, and other third-party inquiries. It is the policy of the IRS National Office to forward such information items to the relevant IRS Key District Offices without comment on the substance. However, in the course of its review of specific cases, the Joint Committee staff identified certain instances in which the stated IRS National Office procedure was not strictly followed.⁷³

The IRS National Office generally does not get directly involved in the conduct of examinations of tax-exempt organizations. From time to time, specialists in the IRS National Office may be consulted informally by IRS Key District Office employees with respect to issues raised in a specific examination or formally through the technical advice request process.

Technical advice requests

The IRS National Office will become directly involved in issues raised by examinations when an IRS Key District Office submits a technical advice request to the IRS National Office. Technical advice is guidance furnished by the IRS National Office as to interpretation and proper application of internal revenue laws, related statutes, and regulations, to a specific set of facts. It is furnished to help IRS personnel take consistent positions on legal issues.

The IRS Key District Office District Director or an Appeals Officer may request technical advice on any technical or procedural question that develops during the consideration of a case.

While a case is under the jurisdiction of an IRS Key District Office District Director or an Appeals Office, a taxpayer may request that an issue be referred to the IRS National Office for technical advice on the grounds that a lack of uniformity exists as to the disposition of the issue, or that the issue is so unusual or complex as to warrant consideration by the IRS National Office. In these cases, if the IRS office having jurisdiction agrees, technical advice must be requested.

Internal Revenue Manual procedures encourage an IRS Key District Offices to submit requests for technical advice on any technical or procedural questions arising at any stage of the proceedings in the IRS Key District Office or Appeals Office. Under the Internal Revenue Manual guidelines, the request should be made at the earliest stage in the proceeding after it is evident that the question cannot be resolved on the basis of law, regulations, or a clearly applicable revenue ruling or other published precedent.

Technical advice requests submitted to the IRS National Office must contain the entire examination file, including all supporting documents. If the examination file is very voluminous, the submitting office may make a written request in advance of submitting the technical advice request that the IRS National Office approve the omission of specific portions of the file. The request must provide a list of all documents that the submitting office wishes to omit and the specific reason for the requested omission.

⁷³ See the discussion in Part III.C.

6. Training of IRS employees with respect to handling of exempt organization examinations

Exempt organization examining agents complete certain basic training similar to the training provided to determination letter specialists. In addition, new agents complete Exempt Organization Examinations, which is a course that provides specialized knowledge of Exempt Organization examination techniques and procedures. This course takes 18 classroom days and three weeks of on the job training. From time to time, specialized training is available on specific Exempt Organization issues such as farmer's cooperatives.

In addition to the training program for new IRS agents, the IRS maintains a continuing education program, which is generally 40 hours per year. Each IRS Key District Office is expected to send participants and instructors to the annual continuing education program.

7. Role of IRS Office of Chief Counsel in examination process

In general

The lawyers in the IRS Office of Chief Counsel perform a variety of functions. The lawyers in the IRS Office of Chief Counsel participate in the development of regulations, rulings, and other published guidance. These lawyers become involved in specific taxpayer cases by (1) working on private letter rulings, field service advice, and technical advice, and (2) providing litigation support.

The tax-exempt organization area is different from other technical areas in that rulings and determinations are handled through the Commissioner's office, rather than through the IRS Chief Counsel's office (as with private letter ruling relating to individual or corporate taxpayers).

IRS District Counsel attorneys

IRS District Counsel attorneys generally are responsible for providing assistance to the Key District Offices. IRS District Counsel's role in exempt organization matters depends on whether the case is in litigation. With respect to cases in litigation in Tax Court, the IRS District Counsel's office is the primary responsible party for litigating the case. The IRS District Counsel office's role is primarily advisory on cases in other than the Tax Court (i.e., the Department of Justice is the primary litigator). The Key District Offices can seek advice – sometimes written and sometimes verbal – from IRS District Counsel. As a practical matter, IRS District Counsel provides procedural and some technical legal assistance during an audit.

Although IRS District Counsel has no formal role in the conduct of an examination, IRS District Counsel attorneys serve as a resource for the field on substantive and procedural legal issues. The Joint Committee staff's review of the process disclosed that it is not uncommon for IRS District Counsel attorneys to be involved in cases, particularly complex cases, from the outset. In addition to providing traditional formal and informal legal advice, IRS District

Counsel may participate in taxpayer interviews, assist in evaluating materials provided by taxpayers, suggest possible lines of further inquiry, and assist the Key District Office in preparing materials for IRS National Office review.

IRS Chief Counsel attorneys in the IRS National Office

There is both formal and informal interaction between the Associate IRS Chief Counsel, Employee Benefits and Exempt Organizations and the Exempt Organizations Division of the IRS National Office with respect to tax-exempt organization issues. Private letter rulings and technical advice memoranda may be referred formally to IRS Chief Counsel for review. With respect to taxpayer conferences, IRS Chief Counsel attorneys may or may not be invited to attend by the Exempt Organizations Division. The responsibility for drafting revenue rulings and procedures rests with the Exempt Organizations Division with assistance from the IRS Chief Counsel's office. The responsibility for drafting regulations rests with IRS Chief Counsel. Published guidance must be approved by the Commissioner of Internal Revenue, IRS Chief Counsel, and the Treasury Assistant Secretary for Tax Policy.

The IRS Office of Chief Counsel may also assist the Assistant Commissioner's office informally on difficult legal issues. With respect to specific taxpayer cases, the IRS Chief Counsel's role is more reactive. The Assistant Commissioner or the Exempt Organization Division may request IRS Chief Counsel's guidance either formally or informally. Under IRS procedures, IRS Chief Counsel or IRS District Counsel must sign off on every final revocation of tax-exempt status (and denials of section 501(c)(3) status), but not on every adverse action taken by the IRS.

8. Special procedures for Church tax inquiries

In general

As described below, special rules apply to IRS audits of churches.⁷⁴ These rules were established by Congress in recognition of maintaining church/State separation. The intent of the rules is to provide special procedural safeguards in connection with IRS involvement with churches.

Requirement of reasonable belief before commencing a church tax inquiry

In general, the IRS may begin a church tax inquiry or examination only if the IRS regional commissioner (or a higher official) reasonably believes, on the basis of facts and circumstances recorded in writing, that an organization (1) may not qualify for tax exemption as a church, (2) may be carrying on an unrelated trade or business, or (3) otherwise may be engaged in taxable activities. A church tax inquiry is defined as any inquiry to a church (other than an examination) that serves as a basis for determining whether the organization qualified for tax-

⁷⁴ Code sec. 7611.

exemption as a church or whether it is carrying on an unrelated trade or business or otherwise is engaged in taxable activities. An inquiry is considered to commence when the IRS requests information or materials from a church of a type contained in church records, other than routine requests for information or inquiries regarding matters that do not primarily concern the tax status or liability of the church itself. For purposes of these rules, a church includes (1) any organization claiming to be a church, or (2) a convention or association of churches. For purposes of these procedures, a church does not include church-supported schools or other organizations incorporated separately from the church.

Notice requirement upon commencement of inquiry

Upon beginning a church tax inquiry, the IRS is required to provide written notice to the church of the beginning of the inquiry. This notice must include (1) an explanation of the concerns that gave rise to the inquiry and the general subject matter of the inquiry, (2) a general explanation of the provisions of the Code that authorize the inquiry or that otherwise may be involved in the inquiry, and (3) a general explanation of administrative and constitutional provisions applicable to the inquiry, including the right to a conference with the IRS before an examination of church records takes place. A church tax inquiry notice must be signed by the appropriate regional commissioner. Although practices vary by region, church tax inquiries are generally reviewed at all levels of the EP/EO division, as well as at the District and Regional Counsel levels.⁷⁵

Second notice and offer of IRS conference

The IRS may examine church records or religious activities only if, at least 15 days before the examination, the IRS provides written notice to the church and to the IRS regional counsel of the proposed examination. This tax examination notice is in addition to the tax inquiry notice previously provided to the church and, like the church tax inquiry notice, is generally subject to review at all levels culminating with the Regional Commissioner on the technical side and with the regional counsel on the legal side.

The notice of examination is required to include (1) a copy of the church tax inquiry notice previously provided to the church, (2) a description of the church records and activities that the IRS seeks to examine, and (3) a copy of all documents that were collected or prepared by the IRS for use in the examination and that are required to be disclosed under the Freedom of Information Act (5 U.S.C. sec 552).

The IRS Regional Commissioner, as part of the notice of examination, must offer the church an opportunity to meet with an IRS official to discuss the concerns that gave rise to the

⁷⁵ For example, the IRS Western Region instituted a procedure in 1997 that requires IRS District Counsel pre-review of church tax notices of inquiry. If the IRS District Counsel agrees that the notice meets the requirements of section 7611, it is forwarded to the Regional Counsel for review, who, in turn, forwards it to the Regional Commissioner for final approval.

inquiry and the general subject matter of the inquiry. The organization may request such a meeting at any time prior to commencement of the examination. If the church requests a meeting, the IRS is required to schedule a meeting within a reasonable time and may not examine church records until after the meeting.

The notice of examination may not be sent to a church fewer than 15 days after the notice of commencement of a church tax inquiry. Thus, at least 30 days must pass between the first notice and the actual examination of church records.

If the IRS does not send a notice of examination within 90 days after sending the notice of inquiry, the inquiry will be considered terminated. If the inquiry is terminated under this provision, any further inquiry regarding the same or similar issues within a five-year period requires the approval of the Assistant Commissioner Employee Plans and Exempt Organizations.

Notification of regional counsel

At the same time notice of an examination is provided to a church, the IRS is required to provide a copy of the same notice to the appropriate IRS Regional Counsel. The Regional Counsel then is allowed 15 days from issuance of the notice in which to file an advisory objection to the examination. (This period is concurrent with the 15-day period during which the IRS is prohibited from examining church records.)

Time limit on church tax inquiries and examinations

The IRS must complete any church tax inquiry and examination, and make a final determination with respect thereto, no later than two years after the date on which the notice of examination is supplied to the church. The running of this two-year period is suspended for any period during which (1) a judicial proceeding brought by the church or its agents against the IRS with respect to the church tax inquiry or examination is pending or being appealed, (2) a judicial proceeding brought by the IRS against the church (or any official thereof) to compel compliance with any reasonable IRS request for examination of church records or religious activities is pending or being appealed, or (3) the IRS is unable to take actions with respect to the church tax inquiry or examination by reason of an order issued in a suit involving access to third-party records. The two-year period also is suspended for any period in excess of 20 days (but not in excess of 6 months) in which the church or its agents fail to comply with any reasonable IRS request for church records or other information.

The two-year period may be extended by mutual agreement of the church and the IRS.

Period for assessment and collection of tax

For examinations involving revocation of tax-exempt status where no return has been filed, the IRS is limited initially to an examination of church records that are relevant to a determination of tax status or liability for the three most recent taxable years preceding the date

on which the notice of examination (i.e., second notice) is sent to the church. If the church is not exempt for any one or more of those years, the IRS may examine relevant records and assess tax (or proceed without assessment), as part of the same examination, for a total of six years preceding the date of the notice of examination.

For examinations relating to unrelated business taxable income and if no return has been filed, the IRS may assess or collect tax for the six most recent years preceding the date on which the notice of examination is sent, with no additional limit on the period of church records which may be examined.

For examinations involving issues other than revocation of exempt status or unrelated business income (e.g., examinations relating to social security or other employment taxes), no special limitation applies if no return has been filed.

The special periods of limitations for church tax liabilities do not increase an otherwise applicable period of limitations if a return was filed by the church. Thus, a three-year limitation period will apply where a church filed a tax return before an examination was held and did not substantially understate income. The special periods of limitation for churches do not apply in any case of fraud, willful tax evasion, or knowing failure to file a return which should have been filed. The applicable period of limitations may be extended by mutual agreement of the church and the IRS.

Declaratory judgment actions regarding tax-exempt status

A church is entitled to bring a declaratory judgment action once the IRS issues a revenue agent's final report ("30-day letter") proposing to revoke a church's tax-exempt status. Thus, in a church tax examination, the agent's final report is, in fact, a "90-day letter," as the church has 90 days to file a petition for declaratory judgment, rather than 30 days, to appeal administratively as provided in non-church examinations.

Regional counsel approval of final IRS determinations

Appropriate IRS Regional Counsel must approve, in writing, (1) any determination of whether an organization does not have tax-exempt status as a church, (2) any determination of whether such an organization is not a church that is entitled to receive tax-deductible contributions, or (3) the issuance of a notice of deficiency to a church following a church tax examination (or, in cases where deficiency procedures are inapplicable, the assessment of any underpayment of tax by the church). Further, the Regional Counsel must state in writing that the IRS has complied substantially with the church tax inquiry and examination procedures.

Prevention of repeated examinations

The IRS Assistant Commissioner (Employee Plans and Exempt Organizations) must approve, in writing, any second tax inquiry or examination of a church, unless the first tax

inquiry or examination resulted in (1) revocation of tax-exemption or an assessment of tax, or (2) a request by the IRS for significant changes in church operational practices (including the adequacy or sufficiency of records maintained to reflect income). The requirement of Assistant Commissioner approval does not apply if the second church tax inquiry or examination does not involve the same or similar issues as the preceding inquiry or examination. Additionally, the requirement applies only to second examinations beginning within five years of the date on which the notice of examination was sent to the church during the prior examination (or, if no notice of examination was sent, the date of the notice of commencement of inquiry).

Exclusive remedy for IRS violation of special church tax procedures

Failure of the IRS to comply substantially with (1) the requirement that two notices be sent to the church, (2) the requirement that a Regional Commissioner approve the commencement of a church tax inquiry, or (3) the requirement that an offer of an IRS conference with the church be made (and a conference held if requested), results in a stay in a summons proceeding to gain access to church records (but not in dismissal of such proceeding) until these requirements are satisfied. This is the exclusive remedy for any IRS violation of the church tax inquiry and examination procedures.

C. Processing of Inquiries and Information Relating to Tax-Exempt Organizations

1. IRS handling of information items

In general

The IRS has specific procedures for the handling of “information items.” Information items are defined broadly by the IRS to include most information that comes to the attention of the IRS outside of the normal scope of work on a taxpayer case. For tax-exempt organizations, information items include (1) any original or copy of a document received from an external source that alleges noncompliance with a tax law on the part of a tax-exempt organization, an issuer of a tax-exempt bond, an instrumentality, a taxable entity, or an individual, or (2) a written document prepared by an IRS employee that describes an issue relating to current or potential noncompliance with a tax law identified by the IRS employee during the processing of an assigned case or as a result of information received by other means, such as allegations received during conferences with taxpayers.

The IRS National Office generally refers information items that it receives to the IRS Key District Office with jurisdiction over the matter. Examples of information items that the IRS National Office typically refers to IRS Key District Offices include the following:

- Letters submitted by the general public, a Member of Congress, or other governmental official concerning a current, former, or purported tax-exempt organization;
- Articles or program transcripts generated by the media concerning a current, former, or purported tax-exempt organization or a class or type of tax-exempt organization;
- Application cases closed adversely or withdrawn, but the organization appears to be operational;
- Application cases closed favorably, with indications the organization may engage in noncompliant activity in the future;
- Private letter ruling cases closed adversely (or withdrawn), with indications that the organization may have already entered into the transaction; or
- Submissions that indicate future activities may generate unrelated business income.

The IRS routinely receives inquiries and information regarding tax-exempt organizations (and individuals related to such organizations). The IRS may receive an inquiry from a taxpayer or his or her designated representative about the taxpayer’s tax matters. A Member of Congress may inquire on a taxpayer’s behalf.

Deficiencies in IRS handling of information items

IRS Key District Office procedures for handling referrals.--Regardless of the source of the information or where in the IRS such information is initially received, it is ultimately forwarded to the IRS Key District Office with geographic jurisdiction over the taxpayer at issue

for review and evaluation. The procedures according to which the four IRS Key District Offices handle referrals underwent a dramatic transformation during the course of the Joint Committee staff investigation. Immediately prior to the commencement of the Joint Committee staff investigation, the Internal Audit review and work done by the Treasury Inspector General had revealed deficiencies in the manner in which the IRS Key District Offices processed, screened, and controlled information items. There were no national procedures in place and these audits revealed, and the Joint Committee staff investigation confirmed, that two of the four IRS Key District Offices had no local procedures either. The other two IRS Key District Offices had incomplete procedures. None of the IRS Key District Offices had recordkeeping systems adequate to track information items from receipt to disposition. In addition, as then permitted under the IRM, referrals not selected for examination were destroyed shortly after evaluation at three of the IRS Key District Offices. In every IRS Key District Office, items were evaluated based on the reviewer's experience and not in accordance with a prescribed set of guidelines.

IRS Key District Office practices.--The Midstates Key District Office based in Dallas had no local procedures for processing information items/referrals. In general, referrals were centralized in the Planning and Special Projects branch where they were evaluated for examination potential by the Return Classification Specialist. No log was maintained of referrals. Referrals with audit potential were entered on AIMS; non-examined referrals were destroyed shortly after evaluation. In January, 1997, the Midstates Key District Office instituted new procedures for tracking referrals through the RICS system.

In the Northeast Key District Office based in Brooklyn, local procedures were in place for processing and tracking referrals. In general, referrals were received in the Returns Program Manager branch. Referrals normally would be attached to Form 5666 and filed in a pending file until the tax return for the year at issue is filed. Referrals were not tracked until they were evaluated by the RCS for audit potential. At that point, a handwritten log of referrals was maintained, which detailed the source of the referral as well as the disposition of the referral. The Northeast Key District Office maintained non-examined referrals for two years.

The Western Key District Office based in Los Angeles did have local procedures instituted in 1994. Under these procedures, referrals were centralized in the Classification Branch. Referrals with examination potential generally were sent out to groups for examination consideration. Referrals were entered into a logbook when received and were tracked manually. Referrals that did not result in examinations were destroyed almost immediately.

In the Southeast Key District Office based in Baltimore, the Exempt Organization Branch Chief received all IRS National Office referrals. Other referrals were forwarded to the Classification Branch for screening. If the referral did not result in selection of a return for examination, it was destroyed after six months. New procedures were implemented in March, 1997 following the consolidation of the Baltimore and Atlanta districts. Under the new procedures, all referrals are forwarded to the Classification Branch and entered into a data base tracking log. The Return Classification Specialist completes a classification record documenting decisions made regarding the referral item (e.g., examination potential, no examination

potential). A review board consisting of the two Exempt Organization Branch Chiefs and the Chief of the Technical Branch meets regularly to screen out and select information referrals for examination. Although the field may survey these returns, they must prepare a form indicating the basis for the survey. In addition, Branch Chief and Division Chief approval is required for all surveyed returns. If the item does not result in an examination, it is retained for two years. A database tracking system indicates the disposition of all referrals. In 1997, the IRS National Office estimated that organizations in the Washington D.C. area (and thus, within the jurisdiction of the Southeast Key District Office) constituted 70 percent of all information items received in the IRS National Office.

IRS Office of Inspection investigation and audit.--In July, 1997, the IRS Office of Inspection completed an investigation into allegations of outside intervention in the employee plans and exempt organization compliance programs. While the investigation did not find any evidence of improper outside influence, it did identify a number of internal control vulnerabilities in the IRS National Office and IRS Key District Office tax-exempt organization operations.⁷⁶ These weaknesses included lack of adequate controls over information items. The Report of Investigation noted that information items were destroyed in the IRS Key District Offices if the related returns were not selected for examination, and the IRS Key District Offices did not document the reasons information items did or did not result in examinations. The Report further noted that internal control vulnerabilities may have contributed to an impression by Congress, other tax-exempt organizations, and the general public that the IRS's examination and determination processes for tax-exempt organizations are susceptible to manipulation by individuals or organizations that utilize the media and/or congressional complaints to voice political views. The internal control vulnerabilities also impacted the IRS's ability to refute readily the allegations of improper outside influence.

Between August and December, 1997, the Internal Audit function of the IRS Office of Inspection conducted a national audit to evaluate the procedures and controls established by the IRS National Office with respect to the processing of information items to ensure that consistent actions were taken, properly documented, and the Federal Government's interest was protected.⁷⁷ Beginning in March, 1997, the Joint Committee staff also reviewed IRS National Office and IRS Key District Office procedures and controls. The two investigations were conducted separately, and the Joint Committee staff did not become aware of Internal Audit's conclusions until issuance of their report in June, 1998. However, both investigations identified the same basic procedural problem. This problem was that there was a lack of written procedures and inconsistent practices at the IRS National Office and in the Key District Offices for receipt,

⁷⁶ The Report also noted that requests for technical advice and assistance referred to the IRS National Office were often subject to significant delays.

⁷⁷ The audit also evaluated IRS National Office procedures and controls over the processing of applications for tax-exempt status and requests for technical advice to ensure that the taxpayers involved were afforded prompt decisions and that all applicable taxes were assessed when appropriate.

control, and retention of information items. Procedures for the processing and retention of information items were issued to the field in December, 1997.

The report issued by Internal Audit in June, 1998, stated that, prior to its investigation, controls over information items were deficient. The report noted that in December 1997, IRS management took steps to require each IRS Key District Office to maintain a record keeping system that tracks the receipt and disposition of all information items. Internal Audit found that controls needed to be further strengthened. Specifically, Internal Audit recommended:

- Establishing time standards for the IRS Key District Offices to evaluate the information items;
- Ensuring that the AIMS management information system properly identify the sources of the information item;
- Requiring the submission of periodic reports from the IRS Key District Offices to the IRS National Office with overall statistics regarding the status of information items, including the number and date of information items received, awaiting classification, selected/not selected for examination, and/or identified for further action;
- Strengthening controls for information items received in the IRS National Office; and
- Establishing standardized retention periods for information items and source documents.

The IRS National Office procedures issued in December 1997 addressed each of these recommendations prior to issuance of the final Internal Audit report.

In July, 1998, in response to the Internal Audit findings, the IRS National Office issued revised Division Operating Procedures which addressed, among other items, the processing of information items. While these procedures generally codified existing practice, they also were intended to ensure consistent, standardized treatment of information received at the IRS National Office and forwarded out to the field.

The following is a description of IRS procedures for handling information and inquiries received from external sources. In general, the IRS National Office correspondence tracking system will track these types of information items until they reach the IRS Key District Offices. At that point, the IRS Key District Office tracking system will track the information item.

IRS procedures relating to handling of third party information

In general

Third party information refers to information received by the IRS in connection with specific taxpayer matters. This information can take a number of forms -- correspondence from a taxpayer, correspondence from a Congressman, media reports, and other information items that come to the attention of IRS employees. Correspondence and information items come to the IRS at many different levels. In its investigation, the Joint Committee staff focused primarily on

information received at the IRS National Office, although IRS Key District Office procedures were also reviewed.

The IRS Office of Legislative Affairs is responsible for controlling the Commissioner's mail, as well as correspondence from Members of Congress, the White House, Treasury Office of the Executive Secretariat, and the Treasury Assistant Secretary for Legislative Affairs. All correspondence received at the IRS Office of Legislative Affairs is controlled on the Executive Control Management System ("ECMS"), a paperless tracking system designed to manage and control correspondence. As of January 20, 1997, ECMS was implemented in the IRS National Office and the four Regional Offices. Prior to the introduction of ECMS, IRS Office of Legislative Affairs controlled correspondence on two separate tracking systems -- a Congressional Correspondence Tracking System ("CCTS") and the Commissioner's Mail Tracking System ("CMTS").

Under ECMS, inquiries related to tax-exempt organizations are forwarded to the Assistant Commissioner Employee Plans and Exempt Organizations. The Assistant Commissioner Employee Plans and Exempt Organizations also receives correspondence directly. Such correspondence is sent to IRS Office of Legislative Affairs for initial processing and then is forwarded to the appropriate division in the Assistant Commissioner's office.

In general, the procedures for handling information items are the same irrespective of the source. These procedures are discussed in detail below. In addition, certain special procedures apply with respect to correspondence and information received from Members of Congress. These special procedures are also discussed.

Handling of information items

IRS National Office procedures.--The following IRS National Office procedures for the handling of information items have been instituted.

An electronic database is maintained for each information item received. The database contains the following information:

- A designated identification number with the numbers running sequentially for each fiscal year (e.g., 980001, 980002, etc.). A single identification number is assigned to an information item, even if such item contains multiple allegations.
- A case control number.
- The name and address of the information source, or the name and office symbols for the IRS employee who identified the issue(s).
- The name, employer identification number (EIN), and address of the subject of the information item. No social security number is listed for an individual.
- The date of receipt of the information item from an external source or the date of the identification of the issue(s) by an IRS employee.

- The AIMS source code to describe the root source of the information item (e.g., third party informant, media report, Member of Congress or the White House, Department of Justice, etc.).
- A numeric code for the recipient of the referral (e.g., Assistant Commissioner, etc.).
- The date the information item was referred to another office.

This database is maintained by Projects Branch 2 in the IRS National Office Exempt Organizations Division. Upon request, the branch generates an Information Items Referral Report that identifies the subjects, sources, and date of disposition of all information items.

IRS National Office procedures require that, for general and congressional correspondence cases involving information items, each technical employee and manager will document fully the action taken with respect to such items. The documentation must, at a minimum, contain entries indicating the date of receipt, the referral recommendation, the referral decision, and the office to which the information item was referred.

Under IRS National Office guidelines, there is no IRS National Office evaluation of information items received from external sources to address the potential need for examination of a tax-exempt organization. All such information items are required to be referred promptly to the appropriate IRS Key District Office for its evaluation of examination potential or to another appropriate office without commenting on the merit of the information. If the information item pertains to an entity with an application for exemption pending in the field, the information item is referred to the Ohio Key District Office. If the information item pertains to an application pending in the IRS National Office, it will be forwarded to the appropriate Technical Branch.

After determining which office has jurisdiction over the subject of the information item, IRS National Office employees prepare an acknowledgment to the external source of the information item. The response to members of the public will acknowledge receipt of the information item and provide the address of the office having jurisdiction to which any further related information should be provided. The response to Members of Congress and other government officials will acknowledge receipt of the information item, provide a brief explanation of relevant legal requirements applicable to the subject of the information item, and provide the name and telephone number of an appropriate IRS National Office contact to provide additional explanation of the legal requirements.

A referral memorandum is prepared to transmit the information item to the appropriate recipient. The original information item is attached to the referral memorandum. The following paragraphs are required to be used in the referral memorandum:

Information received independent of any other work item –

We received the attached information item dated (insert date) from (insert name of external source). The information item pertains to (name of organization/individual whose activities are covered by exempt organization law). We are referring it to you for any action you deem necessary. For your

information, we have also attached a copy of our response to (insert name of external source). If you have any questions, please contact (name and telephone number).

Information received in conjunction with other work item –

As part of our case processing, we identify certain issues which may be indicative of potential compliance problems. We are referring the attached description of issue(s) to you, along with the administrative file, for whatever action you deem necessary. If you have any questions, please contact (name of Branch Chief) on (phone number).

IRS Key District Office procedures.--Under current IRS procedures, IRS Key District Offices are required to maintain a record keeping system or log that tracks the receipt and disposition of all information items, including Forms 5666 (EP/EO Information Report), Form 5346 (Examination Information Report), IRS National Office referrals, and third party information items or referrals of all kinds.

As part of this record keeping system, the IRS Key District Offices are required to ensure that all decisions regarding actions relating to examination case selection or nonselection, including the evaluation and disposition of all information items and source documents, regardless of merit, are documented and associated with the referral record file.

The IRS Key District Offices are required to commence evaluation of information items within 90 days of the date of receipt in the IRS Key District Office to ensure that prompt action is taken on the information received. The classifier or designee is to determine whether the information items have examination potential, no examination potential, or need additional information.

The IRS is currently implementing a procedure by which IRS Key District Offices will be required to analyze formally significant information items received about a tax-exempt organization before initiating an examination or other enforcement action against the organization which is the subject of the information item.⁷⁸ The procedure applies to information items which contain evidence or allegations of inurement, political or lobbying activity, activity that may be protected by the First Amendment, or illegal activity. It also applies to information items concerning high impact or sensitive cases, evidence or allegations presented by a Member of Congress or the White House, or cases in which review is desirable for reasons of fairness or integrity.

When such an information item is received, a committee comprised of at least three experienced tax-exempt organization technical employees (senior agents, returns classification officers, and managers) convene to determine whether the information presented, together with any information the IRS may already have in its possession about the organization, creates a

⁷⁸ These draft procedures became operational on June 1, 1999.

reasonable belief that the facts alleged in the information item about the organization are true and that further action by the IRS is warranted. In cases in which the reasonable belief standard cannot be satisfied, the IRS will take no action on the basis of the information item. This new level of review should help to ensure that the IRS does not respond too readily to negative items about an organization that appear in the press or other media, or that are sent unsolicited to the IRS by third parties.

The IRS Key District Offices are required to submit quarterly reports to the IRS National Office on the status of information item processing. The report must include the following cumulative fiscal year information (including the age of the cases):

- the number of information items received,
- the number of information items awaiting classification,
- the number of information items selected for examination,
- the number of information items not selected for examination, and
- the number of information items identified for follow-up action.

Each IRS Key District Office is required to ensure that all information items and source documents referred to the IRS Key District Office are retained regardless of whether the return of the subject organization is ordered or selected for examination. All information items and source documents are retained and stored in a secure, systematic and retrievable manner for three years from the close of the fiscal year in which the information item is received.

Congressional correspondence

IRS National Office procedures.--Special procedures apply to correspondence received from Members of Congress, irrespective of the level in the IRS at which such correspondence is received.⁷⁹ The IRS Office of Legislative Affairs is responsible for all correspondence from Members of Congress. Congressional inquiries received in other offices must be forwarded to Legislative Affairs for control and assignment.

Congressional correspondence is logged in on the ECMS system and forwarded to the appropriate division director for response. In the case of correspondence relating to tax-exempt organizations, the Exempt Organization Division Director would be the appropriate recipient. Initial inquiries are imaged on ECMS and assigned a control number. Specific due dates for a reply to the initiator will be established. For example, IRS procedures require responses to Congressional inquiries within 5 workdays of the date the correspondence is received by the IRS. The ECMS coordinator is responsible for updating the system to track the correspondence.

A case is considered closed for ECMS purposes only when a final reply has been sent. The IRS Office of Legislative Affairs maintains copies of correspondence for two years and then

⁷⁹ The procedures for IRS National Office handling of Congressional calls and letters are contained in IRM (Chapter 500 of IRM 1(15)29, the Correspondence Handbook.)

it is destroyed. The ECMS system does not track final action on information items or referrals forwarded to IRS Key District Offices.

In its report, Internal Audit recommended that the IRS National Office should maintain a log of those information items forwarded to the IRS Key District Offices for classification, such as date received, source, and date sent to the IRS Key District Office. They further recommended that the IRS Key District Offices should advise the IRS National Office of the disposition of these items. The IRS National Office has implemented these recommendations with the modification that items will be tracked only on a cumulative basis so as not to impact decision making on any specific referral.

IRS Chief Counsel procedures.--The IRS Office of Chief Counsel maintains a separate log of all Congressional and other third party correspondence. Most of the Congressional inquiries received on employee plans and exempt organization matters relate to issues other than tax-exempt organization issues. In addition, most of the Congressional correspondence is a forwarding of constituent mail. Direct letters from Members of Congress tend to be addressed to the IRS Chief Counsel if there is a particular State concern about, or large number of constituents affected by, an issue.

IRS Key District Office procedures.--There is no uniform tracking system for Congressional correspondence received by IRS Key District Offices. Each Key District Office District Director has discretion as to how to track. The Key District Office in Cincinnati and in the Midstates and Western regions use the PROMIS system, which is a computerized tracking system. The Key District Offices in Southeast and Northeast forward information to Customer Service Branch, which maintains a manual log of correspondence that has the Congressperson's name, taxpayer's name and date of receipt. Copies of correspondence typically are kept for short periods of time (e.g., the Southeast Key District Office retains a hard copy of correspondence for only 1 year.) The Internal Audit report stated that ultimately, the exempt organization function needs to have an automated system for tracking information items to provide the IRS National Office with query capabilities and the ability to generate reports. Until such a system is in place, Internal Audit recommended using AIMS to record and control information items, regardless of the final disposition. Previously, items were not entered onto the AIMS system unless they resulted in an examination. The Exempt Organizations Division is implementing a tracking system on RICS to satisfy the Internal Audit report recommendation.

In the case of Congressional correspondence sent to an IRS Key District Office directly, the Key District Office will prepare a response. If the correspondence is case specific, the correspondence is forwarded to either the Taxpayer Advocate or the Customer Service Unit of the applicable Technical Branch for handling and then is forwarded to the appropriate Branch Chief for response. The inquiry is not generally sent to the revenue agent. If allegations of agent misconduct are made in the correspondence, then there are specific procedures that must be

followed.⁸⁰ The majority of Congressional correspondence sent to IRS Key District Offices directly relate to the status of a tax-exempt organization matter pending before the IRS.

If Congressional correspondence is sent directly to a revenue agent handling a case, the agent would note the contact in his or her case chronology log, but would not otherwise be required to report the contact.

Congressional correspondence

During the period January 1, 1994, to April 22, 1997, the IRS National Office received 443 written and oral requests from Congressional offices relating to tax-exempt organization matters. Table 4, below, categorizes these requests by year and by general subject matter. Of the total number of requests during this period, 74 involved taxpayers or Members of Congress objecting to or questioning the tax-exempt status of a particular organization; 26 raised specific questions about the political campaign or lobbying activities of specific tax-exempt organizations; 37 inquiries objected to revocation or potential revocation of tax-exempt status. The majority of requests involved the determination letter process: 102 requested expedited treatment of the determination letter application of a tax-exempt organization; 46 requested information on the status of a determination letter request; and 86 requested assistance in securing tax-exempt status.

⁸⁰ Secs. 0.106 and 0.107(a)(3) of the Department of the Treasury Employee Rules of Conduct, 31 C.F.R. Part O.

**Table 4.--1994-1997 CONGRESSIONAL INQUIRIES
RECEIVED BY THE IRS NATIONAL OFFICE
WITH RESPECT TO TAX-EXEMPT ORGANIZATIONS**

ISSUE RAISED	1994	1995	1996	1997¹
Objects to/questions tax-exempt status of an organization	21	34	21	10
Seeks expedite of determination letter request	34	35	25	8
Seeks assistance obtaining tax-exempt status; supports exemption application of an organization	24	21	41	2
Seeks status of application for tax-exempt status	26	17	3	1
Opposes denial of tax-exempt status; opposes revocation of tax-exempt status; opposes IRS treatment of organization	12	7	18	5
Questions lobbying/political/other activities of a tax-exempt organization	6	6	11	3
Other	4	9	7	3
Total Requests:	126	129	115	115

¹ Through April 22, 1997.

2. Information relating to IRS matters sent to the Treasury Department

General policies with respect to information on IRS matters sent to Treasury Department

Treasury Department officials may receive communications from third parties containing information relating to specific taxpayers. When such correspondence requires an answer that involves taxpayer-specific information, it is Treasury Department practice to forward such correspondence to the IRS for response. In some cases, to avoid the appearance of Treasury involvement in taxpayer-specific matters, Treasury officials receiving such correspondence will advise the writer to contact the IRS directly rather than forwarding the correspondence to the IRS. If the correspondence discusses a specific taxpayer matter in the context of a general issue of tax policy, the correspondence may be referred to the Treasury Office of Tax Policy for a reply to only the tax policy issue.

When the Treasury Department receives oral communications from third parties conveying information about specific taxpayers, Treasury officials generally inform the third party to contact the IRS directly as the agency responsible for specific tax matters. Alternatively, if the official believes that the third party is making a comment concerning a matter of tax policy, the communication may be forwarded to the Treasury Office of Tax Policy. If the communication addresses a specific taxpayer issue in the context of an issue of tax policy, such

as a legislative proposal or a regulation, Treasury Office of Tax Policy staff may review the information to the extent it is relevant for tax policy purposes. However, Treasury Department personnel can only disclose tax information to the extent specifically authorized by the Internal Revenue Code.

It is Treasury Department policy to advise third parties that the Treasury Department exercises no authority over specific taxpayer matters and can consider only general questions of tax policy that may be raised.

Treasury Department procedures for handling of correspondence relating to IRS matters

In general.--Since 1996, the Treasury Office of the Executive Secretariat has had a computer imaging and document tracking system, the Executive Secretariat Correspondence Control System, that has allowed for electronic distribution and storage of correspondence. Correspondence profiles or summaries are recorded into this system. The routing of the correspondence is determined on a case-by-case basis according to the subject matter, the author of the correspondence, and other similar factors.

Files on correspondence and memoranda addressed to the Secretary or Deputy Secretary are kept in the Executive Secretariat files in the Main Treasury building for two years before they are sent to the Federal Records Center in Suitland, Maryland, where they are kept for 25 years before being sent to the National Archives.

The Executive Secretariat Procedures Manual (January 1994) sets forth the guidelines for determining due dates for required responses to correspondence. In the case of Congressional correspondence, the due date is five working days and, in the case of other "VIP" correspondence, the due date is seven working days. There are no written guidelines for assigning priority status; incoming correspondence is reviewed on a case-by-case basis to see if there are reasons why assigning priority status is appropriate (for example, action is requested by a certain impending date).

Treasury Department correspondence relating to tax administration.--The Executive Secretariat forwards "VIP" correspondence that is addressed to the Secretary of the Treasury or Deputy Treasury Secretary and that concerns tax administration to the Correspondence Control staff in the IRS Office of Legislative Affairs. The Executive Secretariat forwards public correspondence that is addressed to the Secretary of the Treasury or Deputy Treasury Secretary and that concerns tax administration to the Support Services Division of the IRS National Office.

White House correspondence relating to tax administration forwarded to the Treasury Department.--Correspondence referred from the White House relating to tax administration is not logged into the Executive Secretariat tracking system; rather, it is forwarded to the IRS unlogged and handled by the IRS. Copies of IRS responses to such correspondence are sent, if at all, directly to the White House.

3. Information relating to IRS matters sent to the White House

In general

The IRS Office of Legislative Affairs routinely receives a large volume of mail forwarded from the White House, most of which involves taxpayer complaints or inquiries or comments on the complexity of the tax laws. A small percentage of this correspondence deals with issues relating to tax-exempt organizations.

The White House has a policy of not forwarding correspondence from constituents directly to the IRS. Rather, the White House sends materials from constituents to the Treasury Department without expressing any view on the correspondence. The correspondence is not separately identified and there is no formal transmittal/receipt document. In general, the White House annotates “Treas/IRS bulk” on the top left corner of correspondence. The Treasury Department will refer the correspondence to the IRS, as appropriate.

Thus, mail from the White House relating to matters within the jurisdiction of the IRS generally is forwarded in bulk to the Treasury Office of the Executive Secretariat in a mail pouch or similar container. Most correspondence received by the White House involving matters related to the IRS is not logged onto any correspondence tracking system at the White House. Occasionally, White House correspondence is sent directly to the IRS courier desk.⁸¹ For example, the White House may periodically fax urgent correspondence to the IRS. Such a fax might occur when a taxpayer faces imminent seizure of property.

The White House Office of Correspondence may log in Treasury Department correspondence when a constituent seeks the President’s assistance in resolving a matter that falls under the jurisdiction of the Treasury Department. The Correspondence Office will forward the letter to the Treasury Department either with a copy of the White House response to the constituent, or with a standard form referral memorandum. In cases that are time sensitive, the Correspondence Office will fax the materials to the Treasury Department. It is White House policy not to take a position on the merits of the constituent’s request.

Although the general form memorandum previously used by the White House to send bulk mail to most Federal agencies requested that the agency return the correspondence along with any response, there was an understanding between the White House and the IRS that the IRS would not comply with this request with respect to taxpayer specific matters. In response to questions raised by the Joint Committee staff, the White House Counsel’s office advised that no one in the White House Correspondence Office could recall any deviation from this practice of referring correspondence without comment. In addition, the White House Counsel’s Office informed the Joint Committee staff that the White House has changed its general form

⁸¹ Upon receipt by the IRS, this correspondence is opened, counted, and date stamped and entered in the Daily Correspondence Received log by type (Congressional, Treasury, Commissioner, and White House).

memorandum to make it clear that the IRS is not expected to provide the White House with a copy of a response to a constituent.

With regard to third party correspondence forwarded to the Treasury Department in bulk by the White House, the White House found no case in which the IRS communicated to the White House its response to a tax-exempt organization. With regard to correspondence forwarded to the Treasury Department, the White House identified four cases since January 1996 in which the taxpayer requested White House assistance on his or her personal tax matters, the White House forwarded the letter to the Treasury Department or the IRS, and the IRS provided the White House a copy of its response to the taxpayer.

In one of the four cases identified by the White House, a taxpayer requested relief from back taxes. In another, the taxpayer raised questions about the account of a dead family member. In the third instance, the individual complained about the application of a tax refund to back taxes. The fourth instance involved a taxpayer's effort to compromise an assessed tax liability. None of the cases identified related to tax-exempt organization matters or individuals associated with tax-exempt organizations. Prior to 1996, White House employees were aware of one similar instance in which the White House was provided a copy of a response to a taxpayer. This instance also did not involve a tax-exempt organization.

If a Member of Congress, other public official, or an organization writes to the President or a senior advisor to the President, that letter may be logged into the White House Office of Records Management. Generally, if such a letter involved a request for assistance with a matter before a Federal agency, it would be sent to the Correspondence Office to forward to the appropriate agency.

The White House Correspondence Office follows up on individual constituent's tax-related matters if the constituent writes or calls the White House more than once. If the constituent writes a follow-up letter, the White House forwards the letter to the Treasury Department. If the constituent calls, the White House generally asks for a letter and then forwards the follow-up correspondence to the Treasury Department. The Correspondence Office also would follow up if a referral came from the President or senior aides. The White House does not seek any particular outcome with regard to the constituent's request.

D. Review of Policies and Procedures With Respect to Employee Conduct

1. IRS policies and procedures

IRS procedures relating to employee misconduct

Under IRS written procedures described below, an employee who exhibits political or other bias, or who otherwise interferes in the processing of tax returns, determination letter requests, or audits, has committed misconduct and is subject to discipline. These acts are subject to the same investigative or disciplinary procedures applicable to other types of employees misconduct.

Exhibiting bias constitutes employee misconduct.--Exhibiting political or other bias or interfering in the processing of tax returns, determination letter requests, or audits, constitutes an abuse of office and a violation of the requirement of impartiality.

The genesis of rules in this area are two Executive Orders that provide that a Federal employee must be impartial in performing his or her official duties and that there may be no misuse of official position (Executive Order 12674, as modified by Executive Order 12731). These rules are reinforced by rules promulgated by the Office of Government Ethics (“OGE”)⁸² requiring that Executive Branch employees shall act impartially and not give preferential treatment to any private organization or individual. These standards apply to every IRS employee. Under these standards, even the appearance of violating the rules is impermissible.⁸³ The standards impose an affirmative obligation on Executive Branch employees who are asked to work on a matter in which a reasonable person with knowledge of the relevant facts would question his or her impartiality to inform the agency of the appearance problem and seek agency guidance whether he or she should participate in the particular matter.⁸⁴ Employees may not participate in a particular matter involving an organization (other than a political party) in which the employee is an active participant where the circumstances would cause a reasonable person with knowledge of the relevant facts to question the employee’s impartiality in the matter. However, an employee is not disqualified from participating in a matter under this requirement merely because of his or her political, religious, or moral views.

⁸² Office of Government Ethics (“OGE”) Standards of Ethical Conduct for Employees of the Executive Branch (Doc. 9077) February 3, 1993, 5 CFR 2635.101(b)(8). See, also, Office of Government Ethics Standard of Ethical Conduct Self Study Guide (Doc. 9076); Interim Handbook of Employee Conduct and Ethical Behavior (Doc. 9335), September 30, 1994; Supplemental Standards of Ethical Conduct for Employees of the Treasury (5 CFR Chapter XXI), May 5, 1995; and Department of Treasury Employees Rules of Conduct (31 CFR Part 0), June 1, 1995.

⁸³ 5 CFR 2635.101(b)(14).

⁸⁴ 5 CFR 2635.502.

The Treasury Department Employee Rules of Conduct require that employees report to the Treasury Inspector General or the then-Chief Inspector of the IRS information indicating criminal conduct or violations of OGE Executive Branch-wide or Treasury Supplemental Standards or Rules.⁸⁵

Procedures followed by IRS when accusations of bias or interference occur.—IRS management is charged with ensuring that employee misconduct does not go undetected and that appropriate disciplinary action is taken. The Treasury Employee Rules of Conduct require bureau heads or their designees to take appropriate corrective or disciplinary action against an employee who violates the government-wide standards, the Treasury Supplemental Rules, or any other law, rule or regulation.⁸⁶ The same standard requires action against a supervisor who fails to carry out his or her responsibilities in taking or recommending corrective or disciplinary action against an employee who has committed an offense. Under these rules, IRS employees are required to report any information they have on misconduct.

Thus, where an allegation of misconduct exists, employees are to report it and management is to review it. The allegation may be resolved by IRS management; for example, the Joint Committee staff found that it is IRS Office of Employee Plans and Exempt Organizations practice for management to review the matter to determine whether it has been handled in an impartial and professional manner. According to the IRS, if an allegation of bias has been made, management will frequently add or replace employees involved in the examination, as appropriate, as a prophylactic measure, even in the absence of any evidence of bias. The IRS management review of such allegations is intended to ensure the quality and impartiality of the exam and IRS management believes that the addition or removal of employees from the exam protects both the accused employee and the taxpayer.

IRS procedures for employee recusal from cases

In general, IRS rules applicable to those instances when an employee should recuse himself or herself from a matter involving a tax-exempt organization because of the employee's political affiliation, membership in an organization, philosophy or other ideology, or for any other reason, stem from the conflict of interest rules, the general duty to act impartially, the duty to avoid even the appearance of a conflict of interest, and the prohibition on misuse of one's position. In certain instances in which IRS employees were accused of improprieties in their handling of an exempt organization case, even though no evidence of bias was sustained, the IRS took the precaution of removing the employee from the case even though no evidence of bias was sustained.

⁸⁵ 31 CFR 0.107(a)(3) (union employees are subject to different rules pending negotiations with management). OGE rules require employees to disclose waste, fraud, abuse, and corruption to appropriate authorities 5 CFR 2635.101(b)(11).

⁸⁶ 31 CFR 0.106.

Policy with respect to political appointees.—The IRS has a longstanding informal policy in place to keep political appointees (i.e., the Commissioner of Internal Revenue and the IRS Chief Counsel) from having involvement in the IRS’s handling of specific taxpayer matters. If there is an issue regarding a specific taxpayer matter, in practice a high-ranking IRS employee will review the matter to determine if the Commissioner should be consulted. Thus, for example, the policy is to screen issues in the Deputy Commissioner’s office to determine whether or not they should be brought to the Commissioner’s attention. This policy, however, does not mean that political appointees are never involved in matters relating to specific taxpayers.

Applicable statutory requirement.—An employee may not participate personally and substantially in a particular matter that, to his knowledge, will have a direct and predictable effect on the financial interest of an organization or entity which the employee services as officer, director, trustee, general partner, or employee.⁸⁷ Violations of the rule are criminal acts and subject employees to corrective or disciplinary actions, including fines and imprisonment.

In addition, under the IRS Restructuring and Reform Act of 1998, certain acts performed by employees in connection with the performance of official duties are grounds for termination. These violations include (1) willful failure to obtain the required approval signatures on documents authorizing the seizure of a taxpayer’s home, personal belongings, or business assets; (2) providing a false statement under oath material to a matter involving a taxpayer; (3) with respect to a taxpayer, taxpayer representative, or other IRS employee, the violation of any right under the U.S. Constitution, or any civil right established under titles VI or VII of the Civil Rights Act of 1964, title IX of the Educational Amendments of 1972, the Age Discrimination in Employment Act of 1967, the Age Discrimination Act of 1975, sections 501 or 504 of the Rehabilitation Act of 1973 and title I of the Americans with Disabilities Act of 1990; (4) falsifying or destroying documents to conceal mistakes made by any employee with respect to a matter involving a taxpayer or taxpayer representative; (5) assault or battery on a taxpayer or other IRS employee, but only if there is a criminal conviction or a final judgment by a court in a civil case, with respect to the assault or battery; (6) violations of the Internal Revenue Code, Treasury Regulations, or policies of the IRS (including the IRM) for the purpose of retaliating or harassing a taxpayer or other IRS employee; (7) willful misuse of section 6103 for the purpose of concealing data from a Congressional inquiry; (8) willful failure to file any tax return required under the Code on or before the due date (including extensions) unless failure is due to reasonable cause; (9) willful understatement of Federal tax liability, unless such understatement is due to reasonable cause; and (10) threatening to audit a taxpayer for the purpose of extracting personal gain or benefit.

Applicable Executive Orders and IRM provisions creating an obligation to recuse oneself from certain cases.—Executive Order 12674 sets forth fundamental principles of ethical conduct

⁸⁷ 18 U.S.C. 208(a), as implemented by the OGE Standards of Ethical Conduct for Employees of the Executive Branch, 5 CFR 2635, subpart D.

for Federal employees and established the Office of Government Ethics.⁸⁸ The Order specifically requires that Federal employees must act impartially and not give preferential treatment to any private organization or individual.⁸⁹ The IRM states the following:

“the mission of the IRS is to encourage and achieve the highest possible degree of voluntary compliance with the tax laws and regulations and to maintain the highest possible degree of public confidence in the integrity and efficiency of the Service. The efficient examination of returns and the impartiality and integrity manifested by examiners are important means of accomplishing this objective.”⁹⁰

With respect to Coordinated Examination Program (“CEP”) audits, the Internal Revenue Manual stresses that the IRS must maintain independence so that judgments, conclusions, and recommendations will be impartial. To this end:

“Members of the CEP examination team should consider anything about their situation that may cause the public to question their objectivity or integrity. Objectivity includes the consideration of the appearance of objectivity. Integrity is not limited to rules of ethics or a code of conduct. If any impairments exist, they will be reported to the appropriate official. Management should evaluate the circumstances and determine whether the impairment(s) would affect the team member’s ability to maintain an independent attitude and approach while conducting the examination.”⁹¹

The IRM states that personal impairments or conflicts of interest include a financial interest in the case assignment, strong political or social convictions that may cause bias regarding the taxpayer, personal or financial relationships that could affect the team member’s objectivity, or any other relationship or preconceived idea which could affect objectivity.

The IRM requires that the appearance of a conflict of interest be dealt with in a manner similar to dealing with an actual conflict of interest. If such a conflict exists, the agent will not continue on the case.

Treasury Inspector General for Tax Administration (“TIGTA”)

⁸⁸ Executive Order 12674 (April 12, 1989), as modified by Executive Order 12731 (October 17, 1990).

⁸⁹ Executive Order 12674, sec. 101(h).

⁹⁰ IRM 7(10)41.1; 7(10)69-3, 130.

⁹¹ IRM 42(11)5.2 (5)(b). While this IRM provision applies to the Examination Division, the principles are followed by the Employee Plans and Exempt Organizations Division pursuant to IRM 7130, which directs the Employee Plans and Exempt Organization Division employees to look to IRM Part IV for subjects not addressed in Part VII.

Prior to the enactment of the Internal Revenue Service Restructuring and Reform Act of 1998, misconduct allegations were referred either to the IRS Office of Inspection or to the Treasury Office of Inspector General.

The IRS Office of Inspection was established on October 1, 1951, in response to publicity revealing widespread corruption in the IRS. The IRS Office of Inspection generally was responsible for carrying out internal audits and investigations that: (1) promote the economic, efficient, and effective administration of the nation's tax laws; (2) detect and deter fraud and abuse in IRS programs and operations; and (3) protect the IRS against external attempts to corrupt or threaten its employees. The Chief Inspector reported directly to the Commissioner and Deputy Commissioner of the IRS.

The Treasury Office of Inspector General was established in 1988 and charged with conducting independent audits, investigations and review to help the Department of Treasury accomplish its mission, improve its programs and operations, promote economy, efficiency and effectiveness, and prevent and detect fraud and abuse. The Treasury Inspector General generally was authorized to conduct, supervise and coordinate internal audits and investigations relating to the programs and operations of the Treasury, including all of its bureaus and offices. However, the Treasury Inspector General did not assume responsibility for either the internal audit or inspection functions of the IRS Office of Inspection, but rather was directed to oversee the internal audits and internal investigations performed by the IRS Office of Inspection.

The IRS Office of Inspection was responsible for reviewing allegations relating to misconduct by IRS employees. However, pursuant to a Memorandum of Understanding entered into in 1990, the Commissioner and the Treasury Inspector General agreed that all allegations of misconduct involving IRS executives and managers (Grade 15 and above), as well as any other allegation involving "significant or notorious" matters were to be referred to the Treasury Inspector General, and that investigations arising out of such referrals generally would be conducted by the Treasury Inspector General.⁹²

The IRS Restructuring and Reform Act of 1998 established a new, independent, Treasury Inspector General for Tax Administration within the Department of Treasury. The IRS Office of Inspection was eliminated, and all of its powers and responsibilities were transferred to the Treasury Inspector General for Tax Administration. In addition, the Treasury Inspector General for Tax Administration was granted the powers and responsibilities generally granted to Inspectors General under the Treasury Inspector General Act of 1978. The Treasury Inspector

⁹² Treasury Directive 40-01 (September 21, 1992) reiterated that the Treasury Inspector General is responsible for investigating alleged misconduct on the part of IRS employees at the grade 15 level and above, and all employees of the IRS Office of Inspection. In addition, Treasury Directive 40-01 stated that the Treasury Inspector General was responsible for investigating alleged misconduct on the part of Office of IRS Chief Counsel employees (excluding employees of the National Director, Office of Appeals).

General for Tax Administration is under the supervision of the Secretary of Treasury, with certain additional reporting to the Oversight Board and the Congress.

The Treasury Inspector General for Tax Administration was created because the Congress believed that the IRS Office of Inspection lacked sufficient structural and actual autonomy from the agency it was charged with monitoring and overseeing. Further, Congress felt that the relationship between the Treasury Inspector General and the IRS Office of Inspection did not foster appropriate oversight over the IRS. The Congress believed that the establishment of an independent Treasury Inspector General within the Department of Treasury whose primary focus and responsibility would be to audit, investigate, and evaluate IRS programs would improve the quality as well as the credibility of IRS oversight.

2. Treasury Department employee involvement in IRS matters

Taxpayer returns and return information are available for inspection to officers of the Department of the Treasury whose official duties require such inspection or disclosure for tax administration purposes (Code sec. 6103(h)(1)). Tax administration means the administration, management, conduct, direction, and supervision of the execution and application of the internal revenue laws, equivalent State laws and statutes, and tax conventions to which the United States is a party (Code sec. 6103(b)(4)). It also includes the development and formulation of Federal tax policy relating to existing or proposed internal revenue laws, related statutes, and tax conventions.

The Treasury Department has had a long-standing policy that officials of the Department do not involve themselves in taxpayer-specific matters, including matters relating to tax-exempt organizations or individuals related to tax-exempt organizations, unless such involvement relates to broad fiscal policy or overall tax administration issues. The general policy and practice of the Treasury Department is that taxpayer-specific administrative matters, including requests for determination letters, surveys for audit, and actual examinations of tax-exempt organizations or individuals associated with them, are handled by the IRS without comment or interference by Treasury officials or employees.

Although officials in the Treasury Department are entitled to obtain taxpayer information to the extent permitted under Code section 6103(h), in most cases such officials do not need to know taxpayer specific information in order to make general policy decisions, oversee tax administration, or formulate legislative and regulatory recommendations. With respect to both tax-exempt organizations and individuals associated with them and other taxpayers, Treasury Department officials try whenever possible to avoid obtaining taxpayer information that is subject to Code section 6103.

Treasury Order 107-05 (March 17, 1995) provides procedures with respect to communications between the Treasury Department and the White House with respect to open investigations, adjudications, or civil and criminal enforcement actions. Under Treasury Order 107-05, it is the general policy of the Treasury Department to provide the White House with

information on open investigations, adjudications, or civil and criminal enforcement actions if it is appropriate from a law enforcement and regulatory perspective. However, the initial contact with respect to all such communications must involve only the Counsel or Deputy Counsel to the President and the General Counsel or Deputy General Counsel of the Treasury Department. Furthermore, Treasury Order 107-05 does not apply to any communication subject to Code section 6103.

3. White House employee involvement in IRS matters

The White House has a strict written policy against any member of the White House staff communicating with the IRS on a matter (except such person's own taxes) without prior approval of the White House Counsel's office. Under the White House written policy, special rules apply to contacts with the IRS. Under these special rules:

“Because of the sensitive investigative and enforcement powers of the IRS, and the confidential personal information the IRS handles, it is White House policy that **no member of the White House staff should have any communication of any type with the IRS without prior approval of the Counsel**, except on their own tax matters. Note that any communication about tax policy or legislation normally can be directed to the Assistant Secretary of the Treasury for Tax Policy.”

EXHIBITS

EXHIBIT 1-1: LIST OF ARTICLES RELATING TO IRS HANDLING OF TAX-EXEMPT ORGANIZATION MATTERS

- *Audit of NRA May Review Use of Funds From Charity*, John Mintz, Susan Schmidt, The Washington Post, June 13, 1995, page A01.
- *I.R.S. is Preparing to Audit N.R.A., Focusing on Deductions*, New York Times, June 15, 1995, page A21.
- *Abortion Politics at the IRS*, The Weekly Standard, April 15, 1996, page 26.
- *Rites Fight: 'God's Laws' v. the IRS's*, Eliza Newlin Carney, National Journal, June 16, 1996, page 1324.
- *Church's Politics Probed by IRS*, Nancy E. Roman, The Washington Times, August 22, 1996, page 8A.
- *IRS Assures Rangel it Maintains Regular Enforcement of Tax-Exempts*, BNA Daily Report for Executives, September 23, 1996, page G-5.
- *The White House Plays Politics With the IRS*, Joseph Farah, Wall Street Journal, October 23, 1996, section A, page 22.
- *The Abuse of Power*, Editorial, The Orange County Register, October 25, 1996, page B06.
- *Archer Concerned IRS May Be Motivated By Politics In Two Ongoing Tax Audits*, BNA Daily Report for Executives, October 28, 1996, page G-4.
- *Tax-Exempt Conservative Groups Face IRS Audits; Republicans Contend Motive Is Political*, Mary Jacoby, Chicago Tribune, January 12, 1997, page 1.
- *IRS Targeted Couple After Clinton Run-In*, Rowan Scarborough, The Washington Times, January 18, 1997, page A8.
- *Reports of IRS Audits Disputed*, Paul Bedard and Rowan Scarborough, The Washington Times, January 24, 1997, page A1.
- *"Enemies" of Clintons Turn Up on Audit List*, editorial from the Lima (Ohio) News, The Tampa Tribune, January 27, 1997, page 9.
- *The Kennedys and the IRS*, Wall Street Journal, January 28, 1997, page 16.
- *Clinton Too, Mixed Politics With Charities*, Lance Gay, Pittsburgh Post-Gazette, January 28, 1997, page A-6.
- *Politics and the IRS -- II, Review and Outlook*, Wall Street Journal, January 28, 1997, page 16.
- *Rightist Group Hit by Surprise Audit*, Rowan Scarborough, The Washington Times, January 30, 1997, page A4.
- *Kennedy Used IRS for Political Purposes, Author Says*, David Burnham (letter to editor), Tax Notes, February 3, 1997, page 652.
- *NRA Won't Release Members' Names*, Rowan Scarborough, The Washington Times, February 3, 1997, page A4.

EXHIBIT 1-1, continued:
LIST OF ARTICLES RELATING TO IRS HANDLING
OF TAX-EXEMPT ORGANIZATION MATTERS

- *Democrats Steered Gifts to Favored Tax-Exempt Group; Fund-Raising: Officials Often Referred Contributors to Vote Now '96. Organization Had Close Ties to the Party*, Los Angeles Times, February 8, 1997, part A, page 1.
- *Labor Nominee Linked to Event for Nonpartisan Group*, David Willman, Los Angeles Times, February 9, 1997, part A, page 19.
- *IRS Planning More Audits of Nonprofits*, Elizabeth MacDonald, Wall Street Journal, February 10, 1997, page 3.
- *IRS Accelerates Probe of Nonprofits for Violations of Tax-Exempt Status*, The Washington Times, February 11, 1997, page A5.
- *IRS Stepping Up Investigations of Nonprofits' Political Activity*, Bob Wells, AP, February 11, 1997.
- *Amcor Battles Old Foe IRS Over Shelters*, Richard B. Schmitt, Wall Street Journal, February 18, 1997, page 10.
- *Politics and the IRS--III*, Review and Outlook, Wall Street Journal, February 18, 1997, page 2.
- *Political Role of Tax-Exempt Groups Questioned*, John King, AP, February 21, 1997.
- *Tax-Exempt Groups Scrutinized as Fundraising Clout Grows*, Rebecca Carr, Congressional Quarterly, February 22, 1997, page 471.
- *IRS May Be Engaging in Politically Motivated Audits...or May Not Be*, Fred Stokeld and Ryan J. Donmoyer, Tax Notes, February 24, 1997, page 985.
- *Political Moves of Tax-Exempt Groups Likely to Come Under Closer Scrutiny*, The Washington Times, February 24, 1997, page A4.
- *IRS Began Using News Stories' Audit Tips Only During 1996*, Rowan Scarborough, The Washington Times, February 25, 1997, page A4.
- *IRS Chief Offers Confidential Tax Data to Congress in Defense of Certain Audits*, Elizabeth MacDonald, Wall Street Journal, February 27, 1997, section C, page 16.
- *No Bias in IRS Audit Selection of EOs, Richardson Says*, Ryan J. Donmoyer, Tax Notes Today, February 27, 1997, 97 TNT 39-2.
- *Richardson Asks Archer, Roth to Use 6103 Power to Investigate Audit Allegations*, Diana Gregg, BNA Daily Report for Executives, February 27, 1997, page G-8.
- *IRS Wants to Open Audits to Prove It Is Nonpartisan*, Paul Leavitt, Anne Willette, USA TODAY, February 27, 1997, page 6A.
- *Tax Experts Call Allegations of IRS Plot Against Conservatives Far-Fetched*, George Rodrigue, Dallas Morning News, March 2, 1997, page 8A.
- *No Bias in Audit Selection of Exempt Orgs, Richardson Says*, Ryan J. Donmoyer, Tax Notes, March 3, 1997, page 1104.
- *Key Lawmakers in House and Senate Favor Formal Inquiry Into IRS Audits*, Jacob M. Schlesinger, Wall Street Journal, March 5, 1997, page 4.

EXHIBIT 1-1, continued:
LIST OF ARTICLES RELATING TO IRS HANDLING
OF TAX-EXEMPT ORGANIZATION MATTERS

- *IRS Admits Wasting \$400 Million*, Stephen Barr, Washington Post, March 6, 1997, page A19.
- *Archer, Roth Agree to Accept IRS Files to Investigate Audit Accusations*, Martha Canon, BNA Daily Report for Executives, March 6, 1997, page G-6.
- *IRS Plans Briefing for Lawmakers to Rebut Audit-Targeting Accusations*, The Washington Times, March 6, 1997, page A4.
- *The White House, the DNC, Vote Now '96 & Donor Headaches*, Kip Dellinger (letter to the editor), Tax Notes, March 10, 1997, page 1347.
- *Taxwriting Committees to Investigate Charges of Conservative EOs*, Ryan J. Donmoyer, Tax Notes, March 10, 1997, page 1257.
- *IRS to Increase Audits on Nonprofits*, Star Tribune (Minneapolis, MN), March 15, 1997, page 8B.
- *Floor Statement on Independent Counsel Resolution*, Senator Carl Levin, March 18, 1997, Vol. 105 Cong. Rec. S. 2403.
- *Politics and the IRS--IV*, Review and Outlook, Wall Street Journal, March 19, 1997, page 18.
- *Evidence of IRS Crackdown on Conservative EOs is Circumstantial, Experts Say*, Fred Stokeld and Ryan Donmoyer, EOTR, March, 1997, vol. 16, page 379.
- *Group Targets Politically Active Churches for Audit*, Elizabeth MacDonald and Jacob M. Schlesinger, Wall Street Journal, March 20, 1997, section A, page 18.
- *Inquiry is Set of Tax Audits for Groups on the Right*, New York Times, March 25, 1997, section A, page 16.
- *Lawmakers Call on JCT Staff to Investigate Reports of Politically Motivated IRS Audits*, BNA Daily Report for Executives, March 25, 1997, page G-3.
- *Investigation Into IRS Audits of Exempt Organizations Ordered*, Tax Analysts Highlights & Documents, March 25, 1997, page 3671.
- *Joint Panel to Probe Allegations of Politically Motivated Audits*, Albert B. Crenshaw, Washington Post, March 25, 1997, page A15.
- *Congressional Panel to Probe Audits by IRS*, Rowan Scarborough, The Washington Times, March 25, 1997, page A1.
- *Tax Committee Asks Staff to Look Into IRS Audits*, Wall Street Journal, March 25, 1997, section A, page 8.
- *JCT Probe of IRS Audit Practices May Include White House*, Kies Says, Tax Notes Today, March 26, 1997, 97 TNT 58-1.
- *Congress to Look Into IRS Audits of Exempt Organizations*, Ryan J. Donmoyer & Fred Stokeld, Tax Notes, March 31, 1997, page 1623.
- *GOP's National Policy Forum May Become Target of Senate Democrats Investigation*, White House Bulletin, March 31, 1997.
- *The Democrats' Charity Shuffle*, Daniel Klaidman and Michael Isikoff, Newsweek,

EXHIBIT 1-1, continued:
LIST OF ARTICLES RELATING TO IRS HANDLING
OF TAX-EXEMPT ORGANIZATION MATTERS

- March 31, 1997, page 35.
- *Auditing the IRS, Review and Outlook*, Wall Street Journal, March 26, 1997, section A; page 18.
 - *The Problem With Congressional Investigations and IRS Audits of Nonprofit 'Political Activities,'* Jeffrey P. Altman, EO Tax Journal, Volume 2, No. 4, p. 37, April 16, 1997.
 - *Church Wins Round Against IRS After It Lost Tax Exemption*, Frank J. Murray, The Washington Times, July 15, 1997, page A8.
 - *Auditing the Auditors; Be It Political Revenge or Real Financial Irregularities, The IRS May Be Barking Up The Wrong Return In Jones, Nonprofits*, The Plain Dealer, September 17, 1997, page 10B.
 - *A Politicized IRS? Stop Selective Audits of Persons, Organizations*, The San Diego Union-Tribune, September 22, 1997, page B-6.
 - *Dirty Tricks and the Clinton Enemies List; Conservative Journalists and the Paula Jones Legal Fund are Targets of the Administration*, Joseph Farah, Los Angeles Times, November 11, 1997, page 7.
 - *Wire-Taps, Audits, Spying Fill Clinton's Bag of Tricks*, Joseph Farah, The Houston Chronicle, November 14, 1997, page A-47.

EXHIBIT 1-2 -- Letter from Commissioner Richardson



COMMISSIONER

DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

February 25, 1997

The Honorable William V. Roth, Jr.
Chairman
Senate Committee on Finance
U.S. Senate
Washington, D.C. 20510

Dear Mr. Chairman:

Recent media reports have alleged politically targeted examinations of tax exempt organizations by the Internal Revenue Service. These reports are inaccurate and misleading and suggest incorrectly that the IRS is enforcing the internal revenue laws for partisan political purposes. Such unfounded reports erode public confidence in the integrity of the IRS, thereby undermining the self-assessment compliance system.

I am writing to you to express our willingness to provide the Finance Committee, as authorized by section 6103(f), information relating to these allegations. I am certain that information will demonstrate the IRS' fair, impartial, and nonpartisan enforcement of the internal revenue laws in the exempt organization arena.

I would also like to explore with you and Congressman Archer having the Joint Committee on Taxation authorize the use of section 6103(k)(3) to permit the IRS to correct the misstatements of fact regarding examinations of tax exempt organizations.

If you have any questions, please do not hesitate to let me know.

Sincerely,

A handwritten signature in cursive script that reads "Caggy Richardson".

Margaret Milner Richardson

cc: The Honorable Bill Archer

EXHIBIT 1-3 -- Letter Directing Joint Committee Staff Investigation

APPENDICES

105TH CONGRESS, 1ST SESSION

HOUSE
BILL ARCHER, TEXAS,
CHAIRMAN
PHILIP M. CRANE, ILLINOIS
WILLIAM M. THOMAS, CALIFORNIA
CHARLES B. RANGEL, NEW YORK
FORTNEY PETE STARK, CALIFORNIA

SENATE
WILLIAM V. ROTH, JR., DELAWARE,
VICE CHAIRMAN
JOHN H. CHAFFEE, RHODE ISLAND
CHARLES GRASSLEY, IOWA
DANIEL PATRICK MOYNIHAN, NEW YORK
MAX BAUCUS, MONTANA

Congress of the United States

JOINT COMMITTEE ON TAXATION
1015 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6453
(202) 225-3621
March 24, 1997

KENNETH J. KIES
CHIEF OF STAFF
MARY M. SCHMITT
DEPUTY CHIEF OF STAFF
(LAW)
BERNARD A. SCHMITT
DEPUTY CHIEF OF STAFF
(REVENUE ANALYSIS)

Kenneth J. Kies, Esq.
Chief of Staff
Joint Committee on Taxation
1015 Longworth House Office Building
Washington, DC 20515

Dear Mr. Kies:

We are troubled by recent reports alleging politically motivated treatment of certain tax-exempt organizations and individuals by the Internal Revenue Service ("IRS"). These reports were the subject of a recent letter from Commissioner Richardson to the Chair and Vice Chair of the Joint Committee on Taxation (copy enclosed). These allegations are very serious and should be carefully reviewed as expeditiously as possible.

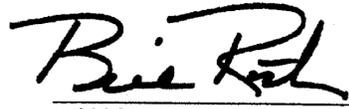
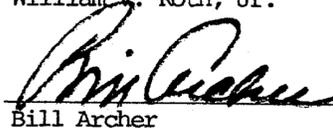
Pursuant to Internal Revenue Code section 8022, we hereby direct the staff of the Joint Committee on Taxation to investigate whether the IRS's selection of tax-exempt organizations described in Code sections 501(c)(3) and 501(c)(4) (and individuals associated with those organizations) for audit has been politically motivated, including an analysis of the selection of such tax-exempt organizations for audit for reasons related to their alleged political or lobbying activities. We expect that you will examine such data and other information as you deem necessary and that you will consult with representatives of the Executive Branch and affected individuals and organizations.

We envision that your investigation will result in a report, as was the case in 1973 and 1975 when the Joint Committee staff investigated certain charges of the use of the Internal Revenue Service for political purposes (JCS-37-73 and JCS-9-75). We ask that the report be completed on or before September 15, 1997.

Sincerely,


Daniel Patrick Moynihan

Charles B. Rangel


William V. Roth, Jr.

Bill Archer

Appendix A.—Tax-Exempt Organizations and the IRS Office of Employee Plans and Exempt Organizations⁹⁴

1. In general

The number of tax-exempt organizations described in Code section 501(c) has nearly doubled since 1974. At the end of fiscal year 1996, there were approximately 1.3 million active tax-exempt organizations and several hundred thousand churches. In contrast, in 1974, there were 690,000 tax-exempt organizations (excluding churches). Assets held by tax-exempt organizations in the United States had risen to \$1.6 trillion in 1998. Health care organizations represent the largest single revenue producer within the exempt sector. The Federal income tax expenditure related solely to the deduction allowed for contributions to charities (a subset of all tax-exempt organizations) is estimated to be \$27.6 billion in 1999, and \$154.2 billion for 1999-2003.⁹⁵

Charitable and educational organizations described in Code section 501(c)(3) have historically constituted the majority of tax-exempt organizations. Social welfare organizations have been the second largest category. Together, these two categories represented 65 percent of the more than 1.1 million tax-exempt organizations in 1994 and 69 percent of all assets in 1990.

2. Establishment and responsibilities of the IRS Office of Employee Plans and Exempt Organizations

Prior to 1974, no one specific office in the IRS had primary responsibility for employee plans and tax-exempt organizations. As part of the reforms contained in the Employee Retirement Income Security Act of 1974 (“ERISA”), Congress statutorily created the Office of Employee Plans and Exempt Organizations under the direction of an Assistant Commissioner.⁹⁶ Employee Plans and Exempt Organizations was created to oversee deferred compensation plans governed by sections 401-414 of the Code and organizations exempt from tax under Code

⁹⁴ The discussion in this section was developed from the Internal Revenue Manual, responses to written requests from the Joint Committee staff to the IRS, and interviews of current and former IRS employees. Under Commissioner Rossotti’s reorganization plan for the IRS, the IRS Office of Employee Plans and Exempt Organizations is being restructured into the Tax Exempt and Government Entities Operating Division. The structure of IRS operations with respect to tax-exempt organizations under the reorganization plan is still being developed.

⁹⁵ Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Year 1999-2003* (JCS-7-98), December 14, 1998.

⁹⁶ Code section 7802(b).

section 501(a).⁹⁷ This office was abolished as a statutory requirement as part of the Internal Revenue Service Restructuring and Reform Act of 1998.⁹⁸ At that time, Congress expressed its intent that a comparable structure be created administratively. In accordance with that directive, the IRS plan of reorganization being implemented under the direction of IRS Commissioner Charles Rossotti creates a separate operating division for the existing Employee Plans and Exempt Organizations function. Similar to the current Employee Plans and Exempt Organizations, the Tax Exempt and Government Entities Operating Division oversees employee benefit plans and tax-exempt organizations. Unlike the current Office of Employee Plans and Exempt Organizations, the Tax Exempt and Government Entities Operating Division also oversees government entities and tribal governments as taxpayers. Because the new operating division parallels in large measure the prior-law structure, the following summary of the Office of Employee Plans and Exempt Organizations' duties and responsibilities that applied during the period covered by the Joint Committee staff investigation should remain generally applicable.

The Office of Employee Plans and Exempt Organizations is responsible for overseeing the administration and enforcement of Federal tax laws relating to employee benefit plans and tax-exempt organizations. The Office of Employee Plans and Exempt Organizations' mandate includes not only enforcing applicable Federal tax laws and collecting the proper amount of tax revenue, but also protecting the rights of benefit plan participants and contributors to and beneficiaries of tax-exempt organizations. In addition to primary responsibility relating to organizations exempt from tax under Code section 501(a), the Exempt Organizations Division has responsibility for the unrelated business income tax rules (Code sections 511-514), the taxation of political organizations (Code section 527), and the administration of IRS activities with respect to tax-exempt bonds.

The two primary programs through which the Office of Employee Plans and Exempt Organizations seeks to ensure compliance with the requirements for tax exemption of nonprofit organizations are the determination letter program and the examination process (described in section Part V). The determination letter program is one in which the taxpayer applies for a ruling from the IRS as to its qualification for tax-exempt status. Currently, approximately 200 IRS technical specialists process tax-exempt organization determination letters. Through its examination process, the IRS seeks to ensure that exempt organizations continue to meet Federal tax requirements in operation. Table 5 sets forth the number of returns filed by tax-exempt organizations, 1990-1998.⁹⁹

⁹⁷ For a summary of the circumstances surrounding the creation of Employee Plans and Exempt Organizations, see Jim McGovern and Phil Brand, *EP/EO- "One of the Most Innovative and Efficient Functions Within the IRS,"* Tax Notes, August 25, 1997, pp. 1099-1104.

⁹⁸ Section 1101 Public Law 105-206 (July 22, 1998).

⁹⁹ Not all tax-exempt organizations are required to file annual information returns (Form 990). For example, churches and certain small organizations are not required to file Form 990. Thus, as set forth below, the total number of tax-exempt organizations far exceeds the number of returns filed annually.

Table 5. -- Returns Filed by Tax-Exempt Organizations

Calendar Year Filing	Number of Returns Filed¹
1990	348,885
1991	374,903
1992	389,294
1993	505,131
1994	510,077
1995	535,094
1996	564,207
1997	607,042
1998	644,496

Source: Internal Revenue Service

¹Includes Forms 990, 990-EZ, 990-PF, 990-T, 990-C, Form 4720, Form 5227, and Form 1065. Figures do not include Form 1120-POL, Status 40 (application pending) returns, amended returns, or prior year returns.

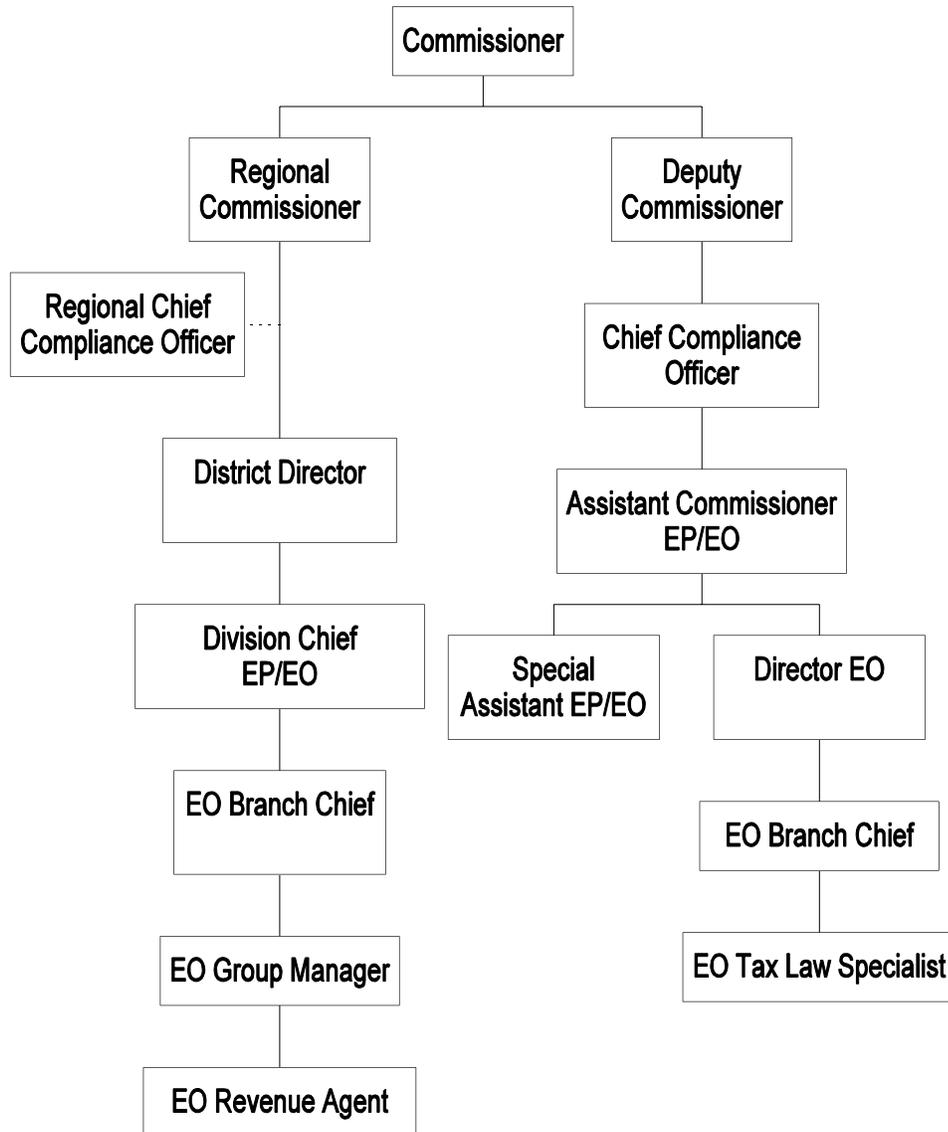
3. Structure of the Office of Employee Plans and Exempt Organizations

The Office of Employee Plans and Exempt Organizations is comprised of IRS National Office headquarters and five key district offices (“Key District Offices”).¹⁰⁰ An overview of the IRS structure for the Exempt Organizations operations is shown in the organizational chart below.

¹⁰⁰ During the period 1990 through 1997, the IRS exempt organizations function underwent several organizational restructurings. Prior to 1995, there were 7 regional offices and 7 corresponding Employee Plans and Exempt Organizations Key Districts: North Atlantic Region - Brooklyn District; Mid-Atlantic Region - Baltimore District; Southeast Region - Atlanta District; Central Region - Cincinnati District; Midwest Region - Chicago District; Southwest Region - Dallas District; Western Region - Los Angeles District. Effective October 1, 1995, the number of Employee Plans and Exempt Organizations Key District Offices was reduced to five based in four regions; Ohio Key District (based in Cincinnati) and the Northeast Key District (based in Brooklyn) were under the purview of the Northeast Region; the Baltimore and Atlanta Key Districts were consolidated into the Southeast Key District (located in Baltimore) under the purview of the Southeast Region; the Midstates Key District (based in Dallas) under the purview of the MidStates Region; and the Western Key District (based in Los Angeles) under the purview of the Western Region.

**Chart 1.--
INTERNAL REVENUE SERVICE**

EXEMPT ORGANIZATION DIVISION ORGANIZATIONAL CHART



IRS National Office

Assistant Commissioner.--The Assistant Commissioner for Employee Plans and Exempt Organizations is responsible for determining the initial resource allocation and program objectives for the IRS Key District Offices via the annual work plan. The Assistant Commissioner provides support to the IRS Key District Offices through technical support, administrative support, and infrastructure systems. The Assistant Commissioner also monitors the delivery of the program services, but does not have line authority over the IRS Key District Offices.

The Assistant Commissioner is responsible for the administration of IRS National Office programs. The Assistant Commissioner oversees the function of the field systems branch and the two technical divisions in the IRS National Office, which issue private letter rulings and technical advice memoranda and coordinate with the Office of IRS Chief Counsel and the Treasury Department on regulations.

In addition, the Assistant Commissioner is responsible for signing any closing agreement with the IRS National Office, any agreement granting Code section 7805(b) relief and, pursuant to Code section 7409, the Assistant Commissioner reviews all field recommendations for injunctive relief for flagrant political activity. The Assistant Commissioner receives briefings on sensitive cases if an IRS Key District Office or the IRS National Office Exempt Organizations Division believes it is necessary.

Exempt Organizations Division.--The IRS National Office Exempt Organizations Division is responsible for uniform interpretation and application of the Federal tax laws involving exempt organizations. It provides policy guidance to the IRS Key District Offices, processes rulings on exemption issues referred by IRS Key District Offices, processes certain determination letter requests, issues rulings on prospective transactions, and issues technical advice and assistance.

There are approximately 90 employees in the IRS National Office Exempt Organizations Division, most of whom are responsible for handling cases in the tax-exempt organization area for which there is no clear established precedent. The Division is responsible for developing procedures for IRS Key District Offices to use in handling cases, but the division has no direct line authority over the IRS Key District Offices. The Division also issues private letter rulings, although some rulings are issued by the Cincinnati office. The Division includes a field compliance branch, which prepares the tax-exempt organization portion of the Employee Plans and Exempt Organizations field work plan and does managerial oversight of field programs. The division works with the IRS Chief Counsel's Office and the Treasury Department in the development of precedential guidance.

The IRS National Office Review Branch chief supervises a staff of senior reviewers, who are responsible for significant tax-exempt organization cases that are referred for conference with the taxpayer. The Branch Chief assigns cases, consults with the reviewers on substantive issues,

and works to assure uniformity of handling of cases.

Adverse cases are forwarded to the Review Branch to determine whether the proposed action is appropriate and to hold the taxpayer's conference of right. This applies both to proposed adverse determination letters and to technical advice requests that are proposed to go against the taxpayer.

IRS Key District Offices

In general.--All IRS field operations are divided among four regions - Northeast, Southeast, Midstates and Western. The employee plans and tax-exempt organization function generally parallels this structure, and is split into five IRS Key District Offices. Examination jurisdiction is vested in four Key District Offices: Northeast (Brooklyn), Southeast (Baltimore), Midstates (Dallas), and Western (Los Angeles). The IRS Key District Office located in Cincinnati, Ohio recently has become the centralized determination letter processing site.

Exempt Organizations Division functions within each IRS Region are, like all other IRS functions, under the direction of the IRS Regional Commissioner and the IRS Regional Chief Compliance Officer. Thus, Exempt Organizations Division functions are subject to the line of authority that operates in each region, as shown in the organizational chart above.

Region.--IRS Regional Commissioners generally are charged with implementation of IRS National Office policy within their respective regions. In general, IRS Regional Commissioners are career IRS employees who have been with the IRS for an average of 30 years. While IRS Regional Commissioners technically report to the IRS Commissioner, each region is relatively autonomous in practice.

Each IRS Regional Commissioner exercises oversight responsibility in the tax-exempt organization area primarily through the IRS Regional Chief Compliance Officer. The duties and responsibility of the IRS Regional Chief Compliance Officer are the following: (1) program oversight, entailing evaluation and improvement of the IRS compliance program; (2) resource allocation among various functions; and (3) ensuring adequate and effective communication, both between the IRS National Office and the IRS Key District Office and between the various functions.

In addition, the IRM provides that an IRS Regional Analyst be designated to coordinate and oversee the employee plans and tax-exempt organization program in each region.¹⁰¹ This person also must develop guidelines and procedures to supplement IRS National Office procedures, identify problem areas and notify the field and the IRS National Office of feasible solutions. The IRS Regional Analyst is responsible for providing assistance to the IRS Key District Offices with respect to day-to-day operations, such as guidance and training.

¹⁰¹ IRM 7913.

In practice, the IRS Regional Commissioner rarely gets involved in specific cases, although particular cases sometimes come to the IRS Regional Commissioner's attention through media articles or taxpayer or Congressional inquiries. Certain regions have a more formalized system than others. For example, in the Western Region, the IRS Regional Commissioner receives quarterly briefings from the IRS Regional Counsel and the IRS Regional Chief Compliance Officer on specific cases. The IRS Regional Counsel will identify one or two high profile or otherwise noteworthy cases, not limited to the exempt organizations area. The discussion focuses primarily on the interaction between the IRS Regional Counsel and the field from a tax administration standpoint and does not include an in-depth analysis of the issues. The purposes of the briefings is to ensure that the IRS Regional Commissioner is informed on important cases within the region; the IRS Regional Commissioner does not make decisions with respect to the handling of specific cases.

The exception to this general rule is with respect to church tax audits. Pursuant to Code section 7611, the IRS Regional Commissioner must approve the initiation of an audit of a church. By the time a request to initiate such an inquiry reaches the IRS Regional Commissioner, it has been cleared through the Employee Plans and Exempt Organizations Division Chief, the IRS Key District Director, and the IRS Regional Commissioner's staff. IRS District and Regional Counsel will also have been consulted. The IRS Regional Commissioner will generally rely on the IRS Regional Chief Compliance Officer to make a recommendation with respect to the request.

District.--Each region is comprised of a number of district offices under the supervision of an IRS District Director. Acting essentially as the CEO of the District, the IRS District Director ensures that policies are set correctly, that the budget is spent appropriately, and that policies that come out of the IRS National Office are implemented. As set forth above, the Exempt Organizations function is centralized in five IRS Key District Offices, and is under the supervision of the IRS District Directors for the district in which the IRS Key District Office is located.

The Employee Plans and Exempt Organizations Division Chief is under the supervision of the District Director for the IRS Key District Office. The Employee Plans and Exempt Organizations Division Chief is generally responsible for ensuring that employee plans and tax-exempt organization operations within the IRS Key District Office meet the IRS National Office annual work plan goals. The Division Chief supervises the Exempt Organization and Employee Plans Branch Chiefs and, accordingly, is responsible for evaluating the Branch Chiefs' performance, providing guidelines and guidance, and setting goals and objectives. The Division Chief is also responsible for keeping the District Director informed about what is going on with respect to employee plans and tax-exempt organization matters; this is accomplished through monthly briefings.

While the Division Chief generally does not get involved in specific case work, the Division Chief receives regular briefings on high-profile cases, such as cases that are likely to generate a lot of media attention, cases that involve complex issues, and cases that will generate

an unusual compliance adjustment. The Division Chief will then, as appropriate, provide a briefing to the IRS Key District Director.

Exempt Organizations Branch Chiefs are responsible for directing the tax-exempt organization program in the IRS Key District Office. The Exempt Organizations Branch Chief ensures that the work plan goals are accomplished and oversees employees within the branch. The Exempt Organizations Branch chief supervises each of the Group Managers within the branch.

The Group Managers generally are responsible for assigning and overseeing work of employees within their groups. They are the direct managers of the revenue agents who handle tax-exempt organization examination and determination letter work. While the agent is directly responsible for the conduct of an audit, his or her group manager is closely involved on a day-to-day basis and provides oversight and guidance with respect to substantive and procedural issues.

Finally, revenue agents have direct responsibility for the day-to-day conduct of an examination or determination letter case. Subject to supervision by the Group Manager, revenue agents are responsible for completing all work on a case in a timely and thorough manner.

Relationship between IRS National Office and IRS Key District Offices

In general.--Although the Employee Plans and Exempt Organizations Assistant Commissioner has general programmatic authority over the field offices, there is no direct line authority. Thus, the IRS National Office cannot initiate or oversee the day-to-day conduct of examinations. Rather, such authority is exercised by the District Directors of the respective IRS Key District Offices who are under the general supervision of the Regional Commissioners. Traditionally, the IRS Regions function as conduits of information and resources between the IRS National Office and the IRS Key District Office.

The IRS National Office has a closer coordination with the IRS Key District Offices in the employee plans and exempt organizations area than in other areas. There is more direct contact regarding programs and resources. There is a limited regional function with respect to tax-exempt organization matters. The IRS National Office meets twice a year with the IRS Region and the Employee Plans and Exempt Organizations Division Chiefs. The IRS Key District Offices provides narratives of their progress on the workplan on a quarterly basis.

Annual work plan.--The IRS National Office issues a draft of the annual work plan guidelines in June for comment to the IRS Key District Offices. In addition, the IRS National Office issues each fall what is referred to as a Measurements Memo, which sets goals and objectives for the upcoming fiscal year. The IRS National Office also issues quarterly monitoring reports to the IRS Key District Offices to evaluate the offices' performance in meeting the work plan goals. These quarterly monitoring reports are generally a response to the quarterly narrative reports sent to the IRS National Office by the IRS Key District Offices.

Work plans are used for guidance and direction in how resources are to be applied for the upcoming fiscal year. In June of each year, the IRS National Office sends a draft for comment of general program direction to the regions setting forth planning guidelines, including staffing and financial guidelines, training guidelines, and determination and examination program guidelines, as well as performance targets. In addition, the IRS National Office specifies the amount of time to be devoted to CEP cases, tax-exempt bond examinations, local and Headquarters projects, and any Nationwide projects to be started during the upcoming fiscal year.

The IRS Key District Offices/Regions respond to the IRS National Office by mid-August with their proposed plans detailing how their resources and time will be spent. The IRS National Office reviews the plans and finalizes them. The final work plan memos are sent out to the IRS Key District Offices/Regions from the IRS National Office by the end of September.

Quarterly Narrative Reports.--Each IRS Key District Office quarterly reports its progress in accomplishing its measurement goals in the annual workplan in the Quarterly Narrative Reports to the IRS National Office from each region; the Quarterly Narrative Reports summarize the activities of each Employee Plans and Exempt Organizations Key District Office. These reports summarize the status of the district's staffing and financial resources, review significant accomplishments and identify areas of concern, and describe the Key District Office's progress in accomplishing business plan objectives, including the status of Headquarters and local projects. The IRS National Office in turn reviews and comments on the narrative reports in the quarterly monitoring reports to the field.

Although each IRS Key District Office gathers information differently, the basis of the quarterly narrative reports in the Baltimore Key District Office are Exempt Organizations branch quarterly operations reports. Through these reports, the chief of the Exempt Organizations branch reports to the Chief of the Employee Plans and Exempt Organizations Division on operations. The reports focus on accomplishment of work plan objectives, summarize the status of headquarters and local projects, and identify the status and issues involved of open or pending cases.

Monthly briefings.--Another managerial oversight tool used in most of the IRS Key District Offices is a monthly briefing from the Chief of the Employee Plans and Exempt Organizations Division to the District Director. These briefings address various topics, including accomplishments, significant and sensitive cases, court testimony, fraud referrals and personnel actions.

Training.--The IRS National Office will schedule meetings and training conferences relating to significant issues such as tax-exempt bonds, colleges, or hospitals.

Line authority.--Although the IRS National Office has no direct line authority over the IRS Key District Offices with respect to the selection of cases for audit, the IRS National Office initiates and coordinates certain nationwide projects. Under these projects, the IRS National Office selects returns in a manner intended to generate a statistically valid sample of taxpayers in

a given market segment (e.g., private foundations of certain size). The market segment is chosen either because the Office of Employee Plans and Exempt Organizations has no information about the segment or because of a specific concern with noncompliance. The projects are initiated to allow the Office of Employee Plans and Exempt Organizations to determine the extent of noncompliance in a segment so that it can more efficiently utilize its resources for educational efforts or examinations. With respect to these returns, the IRS Key District Office generally has no discretion and must audit the return; these returns cannot be surveyed unless the entity no longer exists. The IRS Key District Offices will help identify issues for such projects. This is typically done through meetings by IRS National Office officials with the IRS Key District Office Classification managers.

Over the years, the IRS has initiated several efforts to implement direct line authority between the IRS National Office and the IRS Key District Offices in the employee plans and tax-exempt organization area. Beginning in March, 1994, the IRS conducted a 7-month pilot program whereby the Los Angeles District Director reported on employee plans and tax-exempt organization matters directly to the Assistant Commissioner (Employee Plans and Exempt Organizations) rather than to the IRS Regional Commissioner.

Such an arrangement was not unprecedented. In 1989, the North Atlantic and Central regions participated in a one-year pilot program testing the concept of bypassing the Assistant Regional Commissioner (Exam) for employee plans and tax-exempt organization matters. During this pilot, the IRS Key District Offices in Brooklyn and in Cincinnati were the primary liaisons with the IRS National Office regarding employee plans and tax-exempt organization operational matters. At the close of the pilot, it was concluded that the change in roles provided effective coordination, monitoring and oversight of employee plans and tax-exempt organization programs. Accordingly, the IRS National Office and the region took steps to implement the new arrangement on a permanent basis. During 1990, the IRS District Director served as the liaison with the IRS Assistant Commissioner, Employee Plans and Exempt Organizations with respect to employee plans and tax-exempt organization matters rather than operating through the Regional Commissioner in the North Atlantic, Central, and Midwest regions.

The Office of the Assistant Commissioner (Employee Plans and Exempt Organizations) strongly supported this pilot program, but noted that because the IRS Regional Commissioner's role in church tax inquiries and audits is statutorily mandated in the Code, such duties could not be transferred. Prompted by a downsizing of the Western Regional Office, the proposal sought to reduce layers of management and improve communication and enhance program effectiveness. In particular, it was hoped that a direct relationship between the IRS National Office and the IRS Key District Director would permit better coordination of issues between field personnel and IRS National Office technical personnel. At the close of the pilot, the Western Regional Commissioner, the Assistant Commissioner, Employee Plans and Exempt Organizations, and the Chief Compliance Officer all recommended its permanent implementation, noting that all of the anticipated benefits had been realized with no adverse consequences. However, other Regional Commissioners strongly opposed the move, citing the need for a management layer between the Assistant Commissioner and the District Directors.

According to a former Assistant Commissioner, the Regional Commissioners stated that “we need us, the Regional Commissioners, between you [the EP/EO IRS National Office] and the cases to make sure that we’re not going to face allegations that [then Commissioner] Richardson directed you to do something and you then directed the Key District Director.” According to this former employee, this sentiment was very strong.

4. Role of Office of IRS Chief Counsel in Exempt Organizations Matters

In general

The IRS Office of Chief Counsel employs approximately 1,500 lawyers divided between the IRS National Office and 33 District and 4 Regional Offices. Approximately 600 to 700 of the total are located in the IRS National Office. The Associate IRS Chief Counsel (Employee Benefits and Exempt Organizations) does not have line authority over IRS District Counsel, but provides program oversight advice and review services.

The organizational structure of the Office of the IRS Chief Counsel with respect to employee plans and tax-exempt organization matters parallels that of the IRS National Office. IRS District Counsel attorneys report to Regional Counsel, who, in turn, report to the IRS Chief Counsel. IRS National Office IRS Chief Counsel attorneys report to the Assistant IRS Chief Counsel who reports to the IRS Chief Counsel.

The lawyers in the Office of IRS Chief Counsel perform a variety of functions. The lawyers in the IRS National Office participate in the development of regulations, rulings, and other published guidance. These lawyers become involved in specific taxpayer cases by virtue of working on private letter rulings, field service advice, technical advice, and in litigation support.

The tax-exempt organization area is different from other technical areas in that all rulings and determinations are handled through the Commissioner’s office, rather than through the IRS Chief Counsel’s office (as with individual or corporate private letter rulings). The channeling of rulings through IRS Chief Counsel encourages coordination between all the relevant counsel offices, particularly on tough issues or on those cases likely to reach litigation. However, the process used for tax-exempt organization matters is different. For example, when an IRS Key District Office submits a request for technical advice, the Commissioner’s office may not be required to coordinate the request with the IRS Chief Counsel’s office although such coordination occurs in most adverse cases. If the technical advice is not supported, the IRS Chief Counsel’s office may be forced to concede an erroneous position in court. Because IRS District Counsel may assist the IRS Key District Office with requests for technical advice, IRS District Counsel can help keep the IRS Chief Counsel informed of the technical advice requests that are being submitted.

Role of IRS District Counsel

IRS District Counsel attorneys generally are responsible for providing assistance to the

IRS Key District Offices. IRS District Counsel's role in tax-exempt organization matters depends on whether the case is in litigation. With respect to docketed cases in litigation in the U.S. Tax Court, the IRS District Counsel's office is the primary responsible party for litigating the case. IRS District Counsel's role is primarily advisory to the Justice Department in district court cases and advisory to the IRS Key District Office in any non-docketed cases. The field can seek advice – sometimes written and sometimes verbal – from IRS District Counsel, but the IRS District Counsel's office has no supervisory power. The IRS Key District Office can choose to ignore the advice from IRS District Counsel.

Most IRS cases are non-docketed cases, i.e., cases that are not in litigation. In non-docketed cases, it is not uncommon for IRS District Counsel employees to meet with taxpayers. This is done at the request of the IRS Key District Office. The organizations may be well represented in such meetings and the IRS revenue agent can be overmatched. Sometimes the IRS District Counsel attorney can assist to clarify factual or legal concerns.

IRS District Counsel attorneys may be asked to meet with taxpayers in all kinds of cases, but particularly in highly sensitive cases, or in large case audits. This involvement is not particularly unusual. The involvement of IRS District Counsel can assist in the factual development of the case. Representatives of the IRS Key District Office always take the lead in such meetings. IRS District Counsel is there as a resource for the IRS Key District Office employees to utilize in their handling of a case.

The lawyers in IRS District Counsel have several roles in an audit. The lawyers may have at least informal discussions with the audit staff on legal issues arising in the course of the audit. This occurs particularly in cases that are in the CEP program. More formal interaction between the audit staff and the legal staff occurs when there is an issuance of a summons, or when a revenue agent needs advice on a particular legal issue.

Prior to 1997, IRS District Counsel was not organized to ensure that attorneys with exempt organizations expertise were available to each IRS Key District Office with responsibility for tax-exempt organization matters. Rather, such expertise tended to be scattered. In 1997, the IRS Chief Counsel undertook a nationwide effort to coordinate its assistance to the IRS Key District Offices with respect to employee plans and tax-exempt organization matters. For example, in the Western Region, all employee plans and tax-exempt organization legal work was centralized in the Los Angeles IRS District Counsel's office. All employee plans and tax-exempt organization cases throughout the region were referred to attorneys with specialized training in an effort to enhance the quality and efficiency of legal assistance in the employee plans and tax-exempt organization area.

In an attempt to mirror more closely the structure of the Office of Employee Plans and Exempt Organizations, the Office of IRS Chief Counsel is attempting to identify and train groups of attorneys in the IRS District Counsel's office for each IRS Key District Office who will specialize in tax-exempt organization issues. The training of such attorneys focuses on the substantive issues, as well as the special procedures, that may apply in tax-exempt organization

examinations.

Role of the IRS Chief Counsel

There is both formal and informal interaction between the Office of IRS Chief Counsel and the Exempt Organizations Division with respect to tax-exempt organization issues. Private letter rulings and technical advice memoranda may be referred formally to IRS Chief Counsel for review. With respect to taxpayer conferences, IRS Chief Counsel attorneys may or may not be invited to attend by the Exempt Organizations Division. With respect to regulations, IRS Chief Counsel attorneys take the drafting lead, with involvement from a person from the Exempt Organizations Division and possibly from the Assistant Commissioner's office. The responsibility for drafting revenue rulings and procedures rests with the Exempt Organizations Division with the involvement of a IRS Chief Counsel attorney.

The IRS Chief Counsel plays a proactive role with respect to published guidance. The IRS Chief Counsel has primary responsibility within the IRS for regulations. In addition, notices are within the IRS Chief Counsel's jurisdiction and other published guidance, such as revenue rulings, are extensively reviewed by IRS Chief Counsel attorneys.

The Office of IRS Chief Counsel may also assist the Assistant Commissioner's office informally on difficult legal issues. With respect to involvement in specific taxpayer cases, the IRS Chief Counsel's role is more reactive. The Assistant Commissioner may request IRS Chief Counsel's guidance either formally or informally. The IRS Chief Counsel or IRS District Counsel must sign off on every final revocation of tax-exempt status under 501(c) (and denials of 501(c)(3) status), but not on every final adverse determination letter.

Resolution of conflicts between Associate IRS Chief Counsel and Assistant Commissioner

Disagreements between the Office of Associate IRS Chief Counsel and the Assistant Commissioner as to the proper resolution of a case or treatment of an issue are generally resolved through meetings. In the past, when General Counsel Memoranda were used, a formal reconciliation process existed. The cases that are sent to the IRS Chief Counsel generally are the cases involving difficult or unique issues; for example, this has been the practice with respect to cases involving political activities of exempt organizations.

5. Office of Employee Plans and Exempt Organizations resources

Although total amounts budgeted for the Office of Employee Plans and Exempt Organizations decreased over the period 1990-1997, the amount allocated to the tax-exempt organization function increased. Table 6 sets forth budget allocations for fiscal years 1990 through 1999.

Table 6. -- Employee Plans and Exempt Organizations Budget Allocations, 1990-1999

Fiscal Year	\$ EP/EO Total (\$millions)	\$ EO (\$millions)	EP/EO Travel \$ (\$thousands)¹
1990	132.8	46.5	2,678
1991	132.3	46.8	2,883
1992	140.9	51.0	2,817
1993	143.1	52.7	2,678
1994	129.8	48.3	2,758
1995	132.5	54.3	3,218
1996	128.2	56.1	2,151
1997	130.4	58.7	2,336
1998	131.6	59.2	2,704
1999	137.1	61.7	2,919

Source: Internal Revenue Service

¹ Although travel dollars are not tracked separately for employee plans or tax-exempt organization activities, the IRS estimated that in any year, more than 50 percent of budgeted travel dollars were spent on tax-exempt organization functions.

Overall, amounts budgeted to the Office of Employees Plans and Exempt Organizations represent approximately 3 percent of the total IRS budget.

For 1999, the Office of Employee Plans and Exempt Organizations had 1,989 funded positions. Approximately 250 of these positions were assigned to the IRS National Office and the remainder were assigned to the five IRS Key District Offices. As set forth in Table 7, below, the aggregate staffing level remained essentially what it was when the Office of Employee Plans and Exempt Organizations was formed in 1974. In fact, the 1999 staffing level was more than 20 percent below the 1989 peak staffing level.

Table 7. EP/EO Staffing and Budget Authority		
Fiscal year	Funded positions	President's budget authority¹⁰² (\$ millions)
1975	2,075	N/A
1976	2,175	N/A
1977	2,202	N/A
1978	2,292	62.2
1979	1,945	64.1
1980	1,870	66.9
1981	1,738	68.9
1982	1,640	55.0
1983	1,770	80.8
1984	1,906	90.4
1985	1,902	94.3
1986	2,099	99.0
1987	2,311	104.9
1988	2,562	120.9
1989	2,573	125.8
1990	2,423	132.8
1991	2,336	132.3
1992	2,461	140.9
1993	2,331	143.1
1994	2,305	129.8
1995	2,304	132.5
1996	2,197	128.8
1997	2,112	132.5
1998	1,980	132.8
1999	1,989	138.1

Source: Internal Revenue Service

¹⁰² Pre-1995 totals include funding for support positions from other divisions of the IRS.

Appendix B.—Present-Law Rules Governing Political and Lobbying Activities of Tax-exempt Organizations

1. Present-law restrictions on political and lobbying activities by section 501(c) organizations

In general

Present-law section 501(c) provides for twenty-seven different categories of nonprofit organizations which generally are exempt from Federal income tax.¹⁰³ Different rules apply to lobbying and political campaign activities of such tax-exempt organization depending upon the category of section 501(c) under which the organization is described. The restrictions on an organization's lobbying and political campaign activities generally become more stringent as the Federal tax benefits potentially available to the organization or to the organization's donors increase.

Section 501(c)(3) provides tax-exempt status to certain nonprofit entities organized and operated exclusively for charitable, religious, educational, or certain other purposes, provided that no part of the net earnings of the organization inure to the benefit of any private shareholder or individual. Organizations described in section 501(c)(3), which generally are referred to as "charities," are classified as either public charities or private foundations.¹⁰⁴ In addition to the tax-exempt status conferred on organizations described in section 501(c)(3), charitable contributions to such organizations are tax-deductible to the donor for Federal income, estate,

¹⁰³ These "tax-exempt organizations" generally are exempt from Federal income tax on income derived from activities substantially related to their exempt purposes and on their investment income. However, such organizations generally are subject to tax on any income derived from business activities that are regularly carried on and not substantially related to their exempt purposes. Secs. 511-514.

¹⁰⁴ Sec. 509(a). Private foundations are defined under section 509(a) as all organizations described in section 501(c)(3) other than the organizations granted public charity status by reason of (1) being a specific type of organization (i.e., churches, educational institutions, hospitals and certain other medical organizations, certain organizations providing assistance to colleges and universities, or a governmental unit); (2) receiving a substantial part of its support from governmental units or direct or indirect contributions from the general public; or (3) providing support to another section 501(c)(3) entity that is not a private foundation. In contrast to public charities, private foundations generally are funded from one or a limited number of sources (an individual, family, or corporation) and are subject to a number of restrictions not applicable to public charities. In general, more generous charitable contribution deduction rules apply under section 170 to gifts made to public charities than the rules that apply to gifts made to private foundations.

and gift tax purposes.¹⁰⁵ In addition 501(c)(3) organizations also are eligible for certain tax-exempt financing benefits.

Other tax-exempt entities described in section 501(c) (i.e., non-charities) generally are not eligible to receive contributions that are deductible to the donor for Federal income, estate, or gift tax purposes, with the exception of certain gifts made to a veterans' organization or a domestic fraternal society. Secs. 170(c)(3), 170(c)(4), 2055(a)(3), 2055(a)(4), 2106(a)(2)(A)(iii), 2522(a)(3), and 2522(a)(4). Contributions to certain nonprofit cemetery companies are deductible for Federal income tax purposes but generally are not deductible for Federal estate or gift tax purposes. Sec. 170(c)(5).

Section 527 provides limited tax-exempt status to certain "political organizations" (e.g., political parties, campaign committees, and PACs), which generally are exempt from Federal income tax on contributions they receive, but are subject to tax on their investment income and certain other income. Donors generally are exempt from gift tax on their contributions to such organizations. By definition, the purpose of a section 527 organization is to accept contributions or make expenditures for political campaign (and similar) activities.

The present-law Federal tax rules governing the lobbying and political activities of tax-exempt organizations are described below. In general, although advocacy activities of all sorts are often viewed broadly as "political" in the sense that advocacy may be politically motivated or have political implications,¹⁰⁶ the rules described below distinguish lobbying with respect to legislation from political campaign intervention. Moreover, as discussed below, there is no single definition of lobbying under the Internal Revenue Code, nor is there a uniform definition of political campaign intervention.

Political campaign activities

Section 501(c)(3) organizations

Prohibition of political campaign intervention.--Section 501(c)(3) expressly provides that tax-exempt organizations described in that section may not participate in, or intervene in, any

¹⁰⁵ See secs. 145, 170, 2055(a)(2), 2106(a)(2)(A)(ii), and 2522(a)(2). Organizations described in section 501(c)(3) generally are eligible for reduced postal rates and--depending on the applicable State and local laws--may also be eligible for State and local income, property, and sales tax benefits. See generally Bruce R. Hopkins, The Law of Tax-Exempt Organizations, 41-48 (7th ed. 1998).

¹⁰⁶ See Slee v. Commissioner, 42 F.2d 184, 185 (2d Cir. 1930) (referring to lobbying by charitable organization as "political agitation").

political campaign on behalf of (or in opposition to) any candidate for public office.¹⁰⁷ This statutory prohibition is absolute and applies to both types of section 501(c)(3) organizations--that is, public charities and private foundations. In theory, no amount of political campaign activity is consistent with an organization retaining tax-exempt status under section 501(c)(3).¹⁰⁸

Candidates for public office.--Treasury regulations define the phrase "candidate for public office" as meaning "an individual who offers himself, or is proposed by others, as a contestant for an elective public office, whether such office be national, State, or local."¹⁰⁹ Thus, the section 501(c)(3) prohibition of political campaign intervention applies to elections at the Federal, State, and local level. Attempts to influence appointments of persons to nonelective public offices do not constitute prohibited political campaign intervention for purposes of section 501(c)(3).¹¹⁰

There is no bright-line test for determining the precise moment when an individual

¹⁰⁷ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii) defines an organization that intervenes in any political campaign for or against a candidate for public office as an "action organization" not entitled to section 501(c)(3) status. Treasury regulations use the term "action organization" to describe organizations that intervene in political campaigns and organizations that engage in substantial lobbying activities.

¹⁰⁸ See Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876, 881 (2d Cir. 1988). In practice, however, the IRS may exercise its discretion by not seeking the sanction of revocation of the organization's tax-exempt status in cases in which the violation was unintentional, involved only a small amount, and the organization subsequently corrected the violation and adopted procedures to prevent future improper political campaign activities. See Judith E. Kindell & John F. Reilly, Election Year Issues, in Continuing Professional Education Exempt Organizations Technical Instruction Program for 1993 416-19 (1992) (hereinafter 1993 IRS CPE Text). CPE Texts are prepared regularly by the Exempt Organizations Division of the IRS. They are a nonprecedential source of guidance, but are illustrative of the Service's reasoning on various issues. See also PLR 9609007 (Dec. 6, 1995) (the IRS imposed the sec. 4955 penalty for improper political campaign intervention but did not revoke the organization's tax-exempt status).

¹⁰⁹ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii).

¹¹⁰ See Notice 88-76, 1988-2 C.B. 392; GCM 39694 (Feb. 3, 1988) (concluding that sec. 501(c)(3) organizations may attempt to influence the Senate's confirmation vote on a nominee for a Federal judgeship, because a Federal judge is not ordinarily considered the holder of an elective public office). With respect to the factors the IRS considers to determine whether an office or position is a "public office" for purposes of section 501(c)(3), see 1993 IRS CPE Text, supra, at 404-07; and GCM 39811 (Feb. 9, 1990) (concluding that precinct committeemen were candidates for public office).

becomes a candidate for purposes of the section 501(c)(3) political campaign prohibition.¹¹¹ Once an individual formally declares his candidacy for a particular office, his status as a candidate is clear. An individual who has not yet formally announced an intention to seek public office may, under some circumstances, be considered a candidate, although the fact that an individual is a prominent political figure does not automatically make him a candidate.¹¹² The IRS takes the view that even if an individual is otherwise not a contestant for an elective public office, by supporting the individual for an elective public office, the 501(c)(3) organization itself can cause him or her to become a candidate “proposed by others” for purposes of the political campaign prohibition.¹¹³

Participation or intervention in a political campaign.--Section 501(c)(3) expressly provides that prohibited participation or intervention in a political campaign includes the publishing or distributing of statements on behalf of, or in opposition to, a candidate for public office. In addition, Treasury regulations provide that prohibited political campaign activity includes, but is not limited to, the making of oral statements on behalf of or in opposition to a candidate.¹¹⁴ Organizations described in section 501(c)(3) are prohibited from "directly or indirectly" participating in political campaigns.¹¹⁵

¹¹¹ See Association of the Bar of the City of New York, 858 F.2d at 880 (individual need not be a party nominee, nor run an organized campaign, to be a candidate for sec. 501(c)(3) purposes).

¹¹² See PLR 9130008 (April 16, 1991) (ruling that, although an individual was not an officially announced candidate, he was a candidate for sec. 501(c)(3) purposes when his campaign committee published his record and referred to his “prospective candidacy”). See also 1993 IRS CPE Text, supra, at 407-08 (“The determination of when an individual has taken sufficient steps prior to announcing an intention to seek election, so that he or she may be considered to have offered himself or herself as a contestant for the office, is based on the facts and circumstances. . . . [S]ome action must be taken to make one a candidate, but the action need not be taken by the candidate or require his consent”); Fulani v. League of Women Voters Education Fund, 882 F.2d 621, 630 (2d Cir. 1989) (holding that an independent, third-party candidate “was neither a candidate nor a participant in either of the [Democratic or Republican] primary contests” and, thus, could be excluded from the televised primary debates without violating sec. 501(c)(3)).

¹¹³ See 1993 IRS CPE Text, supra, at 408.

¹¹⁴ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(iii).

¹¹⁵ Id. See Branch Ministries, Inc. v. Rossotti, 40 F. Supp. 2d 15 (D.D.C. 1999) (holding that an organization engaged in prohibited political campaign intervention when it placed a newspaper advertisement that was critical of the moral character of a candidate four days before an election, and the advertisement indicated that it was sponsored by the organization and solicited contributions); TAM 199907021 (May 20, 1998) (concluding that particular

Clear examples of prohibited political campaign intervention would include making or soliciting campaign contributions, providing publicity or volunteer assistance, and paying expenses of a political campaign.¹¹⁶ In situations where there is no explicit endorsement of, or direct provision of financial or other support to, a candidate for elective public office, prohibited political campaign intervention may be implicit, as determined by a consideration of all relevant facts and circumstances.¹¹⁷

communications that were critical of Congress but did not refer to specific candidates by name were not prohibited political campaign activities, while broadcasts that identified a person as a candidate and criticized that candidate by name within months of a primary election constituted improper political campaign intervention, despite educational content).

¹¹⁶ See IRS announcement IR-92-57 (1992). The IRS recently ruled in TAM 9812001 (August 21, 1996) that the section 501(c)(3) political campaign prohibition was violated when an organization made a loan to a related, non-exempt entity that conducted charitable and political campaign activity. The section 501(c)(3) organization did not take any steps to ensure that the related entity did not use the funds for political purposes, so that, under section 527(f), the loan was a contribution to a political organization, regardless of the rate of interest charged on the loan. In addition, the IRS takes the position that prohibited political campaign intervention may, depending on the facts and circumstances, arise when an organization engages in a business transaction with a candidate, such as the rental of mailing lists or the acceptance of paid political advertising. In such cases, not only must the fee charged for the good or service provided by the charity be set at a fair market rate, but the IRS will consider whether the charity has a “track record” of making available the same goods or services on the same terms to other candidates and noncandidates. See 1993 IRS CPE Text, *supra*, at 432-434.

¹¹⁷ See Rev. Rul. 78-248, 1978-1 C.B. 154; 1993 IRS CPE Text, *supra*, at 410-413. The IRS does not use Federal election law “express advocacy” standard; instead, the fundamental test is whether support for or opposition to a candidate is indicated by a particular label used as a stand-in for a candidate. With respect to the issue of whether all facts and circumstances demonstrate implied endorsement of (or opposition to) candidates, the IRS has ruled that “jargon and catch phrases” contained in organization’s fundraising letters demonstrated evidence of bias and constituted improper political campaign intervention, even if, as the organization contended, contributions received in response to the letters were used only to finance nonpartisan, educational activities (PLR 9609007 (Dec. 6, 1995)). Similarly, in TAM 9117001 (Sept. 5, 1990), the IRS ruled that, although a candidate’s name did not appear in materials distributed by an organization, its messages “represent a clarion call” for conservatives to act in next election, and the “cumulative effect” of this activity together with other political involvement evidenced an overall agenda to intervene in political campaigns. In contrast, in TAM 8936002 (May 24, 1989), the IRS found that a program to “use the spotlight” of the 1984 election to educate citizens about peace and arms control issues, including distribution of TV and radio ads that stressed liberal views and were run coincident to the presidential campaign debates, represented a “clarion call to act in November. . . and specifically, [to] vote for a change,” indicated a preference for one candidate. Nevertheless, because the ads arguably could be viewed as

The political campaign prohibition of section 501(c)(3) applies to activities conducted by or on behalf of charitable organizations. When an individual affiliated with a charity engages in political campaign activities (e.g., the individual makes a speech endorsing a particular candidate), the question arises whether the political campaign intervention should be attributed to the charity.¹¹⁸ In this regard, an examination of all the facts and circumstances is necessary to determine whether the individual is acting solely in his or her private capacity (even though the individual's official title with the charity may be used for identification purposes) or whether the individual's political campaign activity should be imputed to the charity (generally by using principles of agency).¹¹⁹ Similar questions of attribution arise in cases where a section 501(c)(3) charity is affiliated with a section 501(c)(4) lobbying organization. In such cases, the independence of the organizations generally will be respected where, despite overlapping governing boards, the entities are separately incorporated, the records and finances show legally distinct entities, and there are reimbursements meeting fair-market-value standards for any shared facilities or services.¹²⁰ Moreover, directors of a charity may, in their individual/private

“nonpartisan,” the IRS “reluctantly” concluded that the education program did not constitute political campaign intervention.

For a discussion of the relevance of intent in determining whether an organization has engaged in political campaign intervention for purposes of section 501(c)(3), see Frances R. Hill, The Role of Intent in Distinguishing Between Education and Politics, 9 J. Tax'n Exempt Orgs. 9 (1997); Jeffrey L. Yablon & Edward D. Coleman, Intent is Not Relevant in Distinguishing Between Education and Politics, 9 J. Tax'n Exempt Orgs. 156 (1998); Gregory L. Colvin, Can a Section 501(c)(3) Organization Have a Political Purpose?, 10 J. Tax'n Exempt Orgs. 40 (1998).

¹¹⁸ See 1993 IRS CPE Text, supra, at 435-36 (explaining that the use of organization's resources or facilities is indicative that actions of individual are attributable to the organization; in some cases, organization may implicitly ratify actions taken by an affiliated individual); Bruce R. Hopkins, Charity, Advocacy, and the Law 400-01 (1992).

¹¹⁹ See, e.g., Rev. Rul. 72-513, 1972-2 C.B. 246 (ruling that a student newspaper's political views were not attributable to the university); Rev. Rul. 72-512, 1972-2 C.B. 246 (ruling that a requirement that students enrolled in a political science course participate in a political campaign of their choice does not constitute prohibited political campaign activity by the university). See also GCM 34631 (Oct. 4, 1971); Internal Revenue Service, Publication 1828: Tax Guide for Churches and Other Religious Organizations at 10 (Announcement 94-112, 1994-42 I.R.B. 20) (employees of organization may express personal political views but generally not in organization publications or at official organization functions); TAM 9635003 (April 19, 1996) (concluding that an organization engaged in prohibited political campaign activity by providing a platform for forum participants to endorse candidates of their choice and by publishing the participants' opinions, even though the organization claimed that it did not endorse any candidate).

¹²⁰ See Regan v. Taxation With Representation of Washington, 461 U.S. 540, 545 (1983); FCC v. League of Women Voters of California, 468 U.S. 364, 399-401 (1984); 1993 IRS

capacities, establish a PAC (referred to as a “non-connected PAC”), so long as they do not use the charity’s resources; but the charity itself may not establish a PAC to conduct or fund political campaign activities.¹²¹

Not all election-related activities are prohibited activities for organizations described in section 501(c)(3). For instance, voter education activities generally do not constitute "participation or intervention" in a political campaign on behalf of or in opposition to a candidate and are, therefore, permissible activities under section 501(c)(3), provided that the activities are nonpartisan in nature.¹²² Publishing a compilation of voting records or responses to candidate questionnaires generally does not constitute prohibited political campaign activity when a wide range of issues are addressed and the published results do not suggest a bias for or against any candidate.¹²³ However, an alleged neutral effort to educate voters may evidence a bias and, thus,

CPE Text, supra, at 437-40. In 1987, Congress enacted section 6033(b)(9), which requires charities to disclose on their annual information returns (Form 990) information about direct and indirect transactions or relationships between a charity and other tax-exempt organizations (e.g., certain lobbying organizations) or political organizations described in section 527. The objective of this provision is to prevent the diversion of funds from a charitable organization’s exempt purposes or misallocation of revenues or expenses between organizations. See H.R. Rep. No. 100-391, pt. 2, at 1616 (1987).

¹²¹ See Treas. Reg. sec. 1.527-6(g). See also Commentary on IRS 1993 Exempt Organizations Continuing Professional Educational Education Technical Instruction Program Article on “Election Year Issues,” prepared by individual members of the Subcommittee on Political and Lobbying Activities and Organizations of the Committee on Exempt Organizations of the Section of Taxation, American Bar Association (Feb. 21, 1995) in 11 Exempt Org. Tax Review 854, 864-65 (1995) (hereinafter 1995 ABA Comments) (requesting clarification from IRS as to when individuals affiliated with a charity are acting solely in their individual/private capacities in establishing a PAC).

¹²² See Fulani v. League of Women Voters Education Fund, 882 F.2d 621 (2d Cir. 1989) (holding that an organization with stated goals to foster voter education and participation in the electoral process, and which sponsored nationally televised primary debates among candidates of the two major political parties, is entitled to sec. 501(c)(3) status). See also Rev. Rul. 86-95, 1986-2 C.B. 73 (conducting a public forum for debate between candidates does not constitute political campaign intervention if the format and issues are selected on a nonpartisan basis); Rev. Rul. 74-574, 1974-2 C.B. 160 (noncommercial broadcast station did not violate sec. 501(c)(3) by providing free air time to all legally qualified candidates on an equal basis); TAM 9635003 (April 19, 1996) (where inviting all legally qualified candidates to a candidate debate is impractical, charity may adopt reasonable, objective criteria for determining which candidates to invite to a debate conducted in a neutral, nonpartisan manner).

¹²³ See Rev. Rul. 78-248, 1978-1 C.B. 154 (charity may disseminate voting records or candidate questionnaires under certain fact patterns).

constitute prohibited political campaign intervention. Under some circumstances, dissemination of otherwise educational materials may be viewed as improper political campaign intervention, such as when an organization widely distributes (during an election campaign) a compilation of voting records of candidates only on a narrow range of issues.¹²⁴ Under other circumstances, a charity may (consistent with sec. 501(c)(3) status) publish a newsletter containing voting records of incumbents on selected issues of interest to the organization, provided that the newsletter is distributed to the organization's normal readership (rather than being distributed to the general public or to any particular congressional district), is not timed to coincide with any particular election, and no comment is made on an individual's qualifications for public office.¹²⁵

Depending on the facts and circumstances involved, candidates may be invited to speak at an event of an organization described in section 501(c)(3) without violating the rule against political campaign intervention. If a candidate is invited to speak in his or her capacity as a candidate, then other candidates also must be invited to speak and there should be no indication of support for, or opposition to, any candidate by the organization. If a candidate is invited to speak in his or her individual capacity other than as a candidate (e.g., the candidate formerly held public office or is an expert in a public policy field), then equal access to all other candidates need not be provided. However, in such cases, the IRS position is that the organization must ensure that the candidate speaks only in his or her individual capacity other than as a candidate, that no mention is made of the individual's candidacy at the event, and that no campaign activity

¹²⁴ See Rev. Rul. 78-248; Rev. Rul. 76-456, 1976-2 C.B. 151 (organization that asked candidates to sign a code of fair campaign practices, and released names of candidates who signed or refused to sign, was intervening in political campaigns).

¹²⁵ See Rev. Rul. 80-282, 1980-2 C.B. 178. The IRS takes the view (and some practitioners agree) that activities may be both educational and political campaign intervention. See 1993 IRS CPE Text, supra, at 414-15; 1995 ABA Comments at 14. See also TAM 8936002 (May 24, 1989) ("Educating the public is not inherently inconsistent with the activity of impermissibly intervening in a political campaign."). More recently, organizations themselves have argued, in seeking recognition from the IRS of their tax-exempt status under section 527, that materials they distributed were educational, yet also constituted political campaign intervention because such materials were intended to influence readers to consider the organization's views when voting. See PLR 9808037 (Nov. 21, 1997).

In addition, even if an activity initially meets the test of being "educational" and does not constitute prohibited political campaign intervention, the activity may be conducted in a manner that results in substantial private benefits inconsistent with the organization's tax-exempt status under section 501(c)(3). See Treas. Reg. sec. 1.501(c)(3)-1(d)(1)(ii); Better Business Bureau v. United States, 326 U.S. 279 (1945) (observing that regardless of the number or importance of truly educational purposes, the organization was not operated exclusively for educational purposes due to its objective of pursuing an ethical and profitable business community); American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989) (holding that a training school for campaign staff workers was not entitled to sec. 501(c)(3) status due to the private benefit conferred upon the Republican party).

occurs in connection with the event.¹²⁶

Voter registration and "get-out-the-vote" drives are permissible activities for public charities, provided that the voter registration or "get-out-the-vote" drives are nonpartisan and not specifically identified by the organization with any candidate or political party.¹²⁷ However, voter registration drives conducted by private foundations may be subject to penalty excise taxes unless specific statutory criteria are satisfied under section 4945(f) (discussed further below).

If a charity endorses, rates, or evaluates the qualifications of candidates for elective public office, then the political campaign intervention rule of section 501(c)(3) has been violated, even if the endorsements or ratings are allegedly based on neutral assessments of the candidates' professional, intellectual, or ethical qualifications, rather than partisan grounds.¹²⁸ Moreover, the IRS has concluded that, even if a charity itself and its employees do not formally endorse any candidate, prohibited political campaign activity occurs if the charity provides a platform for others to endorse candidates by conducting candidate forums and publishing ratings of (or opinions about) candidates proffered by potential voters who attend the forums.¹²⁹

Attempts to influence the outcome of voting by the public on referendums, initiatives, or constitutional amendments are not prohibited political campaign activities for public charities, but are considered "lobbying" activities and, thus, are subject to the limitation that such activities

¹²⁶ See 1993 IRS CPE Text, *supra* at 430-432.

¹²⁷ See Treas. Reg. sec. 1.527-6(b)(5); TAM 9117001 (Sept. 5, 1990) ("[I]t is not a section 501(c)(3) purpose to only register and educate voters to vote for favored candidate or party"). Under some circumstances, voter participation efforts undertaken by charities may be targeted to certain politically disadvantaged (or other) groups, even if it is likely that members of the targeted group will vote disproportionately for candidates of a certain party. See PLR 9223050 (March 10, 1992) (targeting of voter participation efforts to homeless persons); PLR 8822056 (March 4, 1998) (targeting of efforts to minority, low-income, and immigrant groups).

¹²⁸ See Association of the Bar of the City of New York v. Commissioner, 858 F.2d 876 (2d Cir. 1988) (rating of judicial candidates against general standards of competence was prohibited activity); Rev. Rul. 67-71, 1967-1 C.B. 125 (rating of school board candidates was prohibited activity, even if process was objective and intended to inform public about candidates).

¹²⁹ See TAM 9635003 (April 19, 1996) (ruling that forums were composed of participants selected through a scientific method to reflect the democratic characteristics of a community, but publication of the participants' ratings of the candidates was improper political campaign intervention). The IRS further concluded in TAM 9635003 that section 501(c)(3) was not violated the year that the organization conducting the forums published a final report that merely listed questions posed to the candidates and their responses but did not include the opinions of forum participants with respect to rating (or qualifications of) the candidates.

not be "substantial"¹³⁰ (see discussion below of lobbying rules). Similarly, efforts to influence the issues addressed in the platform of a political party have been viewed as a lobbying effort and not prohibited political campaign intervention.¹³¹ However, such expenditures made by private foundations to influence referendums or party platforms (even if not substantial) potentially may be subject to penalty excise taxes under section 4945 (as discussed below).

Penalty excise taxes

Private foundations are subject to revocation of their tax-exempt status under section 501(c)(3) if they engage in prohibited political campaign activity. Moreover, private foundations (and their managers) are subject to penalty excise taxes under section 4945 if the foundation makes a "taxable expenditure."¹³² For this purpose, "taxable expenditures" include any amount paid to influence the outcome of a specific public election or to carry on (directly or indirectly) voter registration drives, unless the activities are nonpartisan, are not confined to one specific election period, are carried on in five or more States, and certain other conditions are satisfied.¹³³

¹³⁰ Treas. Reg. sec. 1.501(c)(3)-1(c)(3).

¹³¹ See Hopkins, Charity, Advocacy, and the Law, *supra*, at 399.

¹³² Section 4945 imposes an excise tax penalty on private foundations equal to 10 percent of the amount of their taxable expenditures. Any foundation manager who, without reasonable cause, agrees to make an expenditure knowing that it is a taxable expenditure is subject to a penalty equal to 2.5 percent of the amount of the expenditure (not exceeding \$5,000 per expenditure). Furthermore, if the taxable expenditure is not "corrected" (i.e., recovered to the extent possible within a specified time period and additional safeguards established to prevent future taxable expenditures), then an additional (so-called "second-tier") tax is imposed on the foundation equal to 100 percent of the amount of the expenditure, and an additional tax is imposed on any foundation manager who refuses to agree to correction equal to 50 percent of the amount of the expenditure (not exceeding \$10,000 per expenditure). The IRS is not to assess, or is to abate or refund, any initial (so-called "first-tier") excise tax on political expenditures if the foundation or manager establishes to the satisfaction of the IRS that (1) the political expenditure was not willful and flagrant, and (2) the political expenditure was corrected within a specified time period. Sec. 4962.

¹³³ Secs. 4945(d)(2) and 4945(f). In addition, under section 507(a)(2), willful repeated violations (or a willful and flagrant violation) of the private foundation rules giving rise to penalty excise taxes can lead to termination of private foundation status, and the organization can be required to pay the Federal Government a termination tax equal to the lesser of (1) the value (with interest) of all tax benefits received (by the organization or certain substantial contributors thereto) by reason of the organization's former status under section 501(c)(3), or (2) the net value of the foundation's assets. This penalty may be abated to the extent that the organization contributes its assets to one or more existing section 501(c)(3) public charities, or if certain corrective action is initiated under State law to insure that the assets of the foundation are

Prior to the Omnibus Budget Reconciliation Act of 1987 (“1987 Act”), the only enforcement tool available to the IRS in cases where a public charity engaged in prohibited political campaign intervention was revocation of the organization’s tax-exempt status under section 501(c)(3). This sanction, however, was often viewed as an ineffective remedy, because revocation could be too severe in some cases, or irrelevant in other cases because the organization had ceased operations after its resources were improperly depleted. Consequently, the 1987 Act extended to public charities the two-tiered penalty excise structure applicable to private foundations. Under section 4955, if any charitable organization described in section 501(c)(3), including a public charity, makes a political expenditure, the organization is subject to an excise tax equal to 10 percent of the amount of the expenditure.¹³⁴ Additional penalty taxes may be imposed if the violation is not corrected within a specified time period.¹³⁵

The penalty excise tax under section 4955 may be imposed in addition to the sanction of revocation of the organization's tax-exempt status (and eligibility to receive tax-deductible contributions) by reason of its political campaign activities.¹³⁶ Consistent with section 501(c)(3), section 4955 does not permit a de minimis amount of political campaign intervention. However, the Treasury Department indicated when it issued final regulations regarding section 4955 that “there may be individual cases where, based on the facts and circumstances such as the nature of the political intervention and the measures that have been taken by the organization to prevent a recurrence, the IRS may exercise its discretion to impose a tax under section 4955 but not to seek

preserved for charitable purposes. Sec. 507(g).

¹³⁴ As under the section 4945 penalty regime, a 2.5 percent penalty excise tax may be imposed under section 4955(a)(2) on organization managers who knowingly agree to make improper political expenditures (not exceeding \$5,000 per expenditure). The IRS is not to assess, or is to abate or refund, any initial (so-called "first tier") excise tax on political expenditures if the organization or manager establishes to the satisfaction of the IRS that (1) the political expenditure was not willful and flagrant, and (2) the political expenditure was corrected within a specified time period. Sec. 4962.

¹³⁵ In cases where the political expenditure is not corrected within a specified time period, section 4955(b) provides that the organization is subject to a so-called “second tier” excise tax penalty equal to 100 percent of the amount of the political expenditure. Managers who refuse to agree to correction are subject to an excise tax penalty equal to 50 percent of the amount of such expenditure (not exceeding \$10,000 per expenditure).

¹³⁶ See H.R. Conf. Rep. No. 100-495, at 1020 (1987). To prevent imposition of multiple excise tax penalties on the same political campaign expenditure, section 4955(e) provides that if a tax is imposed under section 4955, then no penalty tax may be imposed under section 4945, which otherwise applies to taxable expenditures made by private foundations, or section 4958, which provides for intermediate sanctions in cases where public charities engage in certain excess benefit transactions with insiders.

revocation of the organization's tax-exempt status."¹³⁷

For purposes of section 4955, the term "political expenditure" is defined (by tracking the sec. 501(c)(3) language) as any expense incurred by a charity in participating or intervening in a political campaign for or against a candidate for public office. In addition, in the case of an organization claiming section 501(c)(3) status but which, in fact, was formed (or which is effectively controlled and availed of) primarily for purposes of promoting the candidacy or potential candidacy of an individual for public office, section 4955(d)(2) enumerates certain expenditures--such as expenses for travel by such individual, for conducting surveys or preparing materials for use by the individual, or for advertising or fundraising--as being included in the term "political expenditure."¹³⁸ Expenditures for voter registration, voter turnout, or voter education constitute "political expenditures" subject to the section 4955 excise tax only if the expenditures violate the prohibition on political campaign activity provided in section 501(c)(3).¹³⁹

The 1987 Act also included other provisions to enhance the IRS' ability to enforce the prohibition against political campaign expenditures, including section 6852 (which authorizes the IRS to make an immediate determination and assessment of taxes in cases where there have been flagrant political campaign expenditures by a charity), section 7409 (which provides that the IRS may seek an injunction from a Federal district court in such cases to prevent future improper expenditures), and section 504(a)(2)(B) (which provides that an organization--other than a church--that ceases to qualify for tax-exempt status under sec. 501(c)(3) by reason of its political campaign activities cannot at any time thereafter qualify as a tax-exempt social welfare organization under sec. 501(c)(4)).¹⁴⁰

Other 501(c) organizations

In general.--Tax-exempt organizations other than those described in section 501(c)(3)

¹³⁷ T.D. 8628, 60 Fed. Reg. 233 (1995) (containing final regulations regarding sec. 4955). See also 1993 IRS CPE Text, *supra*, at 416-419; TAM 9635003 (April 19, 1996) (publication of candidate ratings from citizen caucuses resulted in imposition of sec. 4955 taxes but not revocation of tax-exempt status).

¹³⁸ See Treas. Reg. sec. 53.4955-1(c)(2)(ii) (stating that the determination of whether the primary purpose of an organization is promoting the candidacy of an individual is made on the basis of all facts and circumstances).

¹³⁹ See Treas. Reg. sec. 53.4955-1(c)(2)(iii).

¹⁴⁰ However, a charity that engages in political campaign activities and, consequently, loses its tax-exempt status for a taxable year generally may apply for restoration of its section 501(c)(3) status for a subsequent taxable year, during which it will continue to be subject to the political campaign prohibition and other rules of section 501(c)(3).

generally are permitted to engage in political campaign activities.¹⁴¹ However, political campaign activities cannot be the primary activities of an organization described in section 501(c), such as a social welfare organization described in section 501(c)(4).¹⁴² Instead, organizations that primarily conduct or fund political campaign activities are eligible for a limited tax-exempt status under section 527 (discussed below).

Even though a 501(c) organization (other than a charity described in section 501(c)(3)) that engages in political campaign activities will generally retain its tax-exempt status so long as such activities are not the primary means of accomplishing its purposes, such activities nonetheless will result in the organization being subject to tax under section 527(f) on the lesser amount of its investment income or the amount expended on political activities.¹⁴³ However, a non-charity may establish a separate segregated fund, which may be treated as a separate organization under section 527(f)(3), such that the expenditures and investment income of the fund will not be attributed to the sponsoring organization.¹⁴⁴

Associations that receive tax-deductible dues.--As a result of the Omnibus Budget Reconciliation Act of 1993 ("1993 Act"), tax-exempt trade associations and certain other tax-exempt organizations (but not charities described in section 501(c)(3)) generally are required to provide annual information disclosure to members (sometimes referred to as "flow-through information disclosure") estimating the portion of their dues allocable to political campaign activities, as well as any lobbying activities as defined under section 162(e)(1).¹⁴⁵ However, such

¹⁴¹ However, some tax-exempt organizations (such as section 501(c)(2) title-holding companies) appear to be precluded from political campaign activities because the subparagraph in which they are described limits them to an exclusive purpose that does not include advocacy activities. See 1993 IRS CPE Text at 478.

¹⁴² See Treas. Reg. sec. 1.501(c)(4)-1(a)(2)(ii) ("[P]romotion of social welfare does not include direct or indirect participation in political campaigns on behalf of or in opposition to any candidate for public office"); Rev. Rul. 81-95 1981-1 C.B. 332. See also 1993 IRS CPE Text, supra, at 479.

¹⁴³ See discussion of sec. 527 below. The purpose of section 527(f) is to prevent organizations from using their otherwise tax-free investment income to fund political campaign activities.

¹⁴⁴ Treas. Reg. sec. 1.527-6(b)(1)(I) allows a noncharity to incur certain overhead and administrative expenses (i.e., "indirect expenses") with respect to a PAC without the noncharity being subject to tax under section 527(f) with respect to such expenses.

¹⁴⁵ The purpose of this rule is to prevent taxpayers from avoiding section 162(e) (which disallows trade or business expense deductions for political campaign and lobbying expenditures) by paying otherwise deductible dues to a trade association or other tax-exempt entity which, in turn, makes political campaign or lobbying expenditures on behalf of its dues-paying members.

disclosure is not required for an organization that (1) incurs only a de minimis amount (i.e., \$2,000 or less) of in-house political campaign and lobbying expenditures during the taxable year; (2) elects to pay a 35-percent proxy tax on its political campaign and lobbying expenditures incurred during the taxable year rather than provide flow-through information disclosure to its members; or (3) establishes pursuant to Treasury Department rules that substantially all of its dues monies are paid by members not entitled to deduct such dues in computing their taxable income (sec. 6033(e)).¹⁴⁶

Lobbying

Section 501(c)(3) organizations

In general.--The Internal Revenue Code rules governing lobbying by charitable organizations described in section 501(c)(3) can be viewed as creating three separate regimes. There is a separate set of rules for private foundations under section 4945. In addition, with respect to public charities, the Code differentiates between public charities that affirmatively elect to be subject to special rules under sections 501(h) and 4911 (commonly referred to as “electing public charities”) and all other public charities that do not make this election (commonly referred to as “non-electing public charities”).¹⁴⁷ In general, the operation of the lobbying restrictions does not depend on whether the lobbying activities of a charity are intended to further its charitable purposes (with an exception for so-called “self-defense direct lobbying,”

Accordingly, section 162(e)(3) specifically provides that no trade or business expense deduction is allowed for the portion of dues paid to a tax-exempt organization which the organization notifies the taxpayer under section 6033(e) is allocable to political campaign or lobbying expenditures made by the organization.

¹⁴⁶ Such Treasury Department rules are contained in Rev. Proc. 98-19, 1998-7 I.R.B. 30, which exempts from the section 6033(e) flow-through information disclosure requirements all tax-exempt organizations other than: (1) social welfare organizations described in section 501(c)(4) that are not veterans organizations; (2) agricultural and horticultural organizations (but not labor unions) described in section 501(c)(5); and (3) business leagues and trade associations described in section 501(c)(6). In addition, an organization falling within one of these three categories of tax-exempt entities that generally are subject to the section 6033(e) requirements is nonetheless entitled to an exemption under Rev. Proc. 98-19 if: (1) more than 90 percent of all annual dues (or similar amounts) are received from persons who each pay annual dues of \$75 or less (provided that the organization is not described in section 501(c)(6)); (2) more than 90 percent of all annual dues are received from charities, governmental entities, or tax-exempt organizations which themselves are exempt from the section 6033(e) rules; or (3) the organization maintains records (and notifies the IRS) that 90 percent or more of the annual dues paid to the organization are not deductible to its members, without regard to any political campaign or lobbying expenditures made by the organization.

¹⁴⁷ See generally Hopkins, Charity, Advocacy, and the Law, supra, 130-235.

described below).¹⁴⁸ However, whether or not public policy discussions (even if technically not lobbying) are intended to benefit a large segment of the population or a charitable class, as opposed to the private interests of a limited group of individuals, may be relevant to the determination whether the activity satisfies the section 501(c)(3) requirement that the organization be “operated exclusively” for charitable or other exempt purposes or, instead, whether the organization serves substantial non-exempt purposes inconsistent with section 501(c)(3) status. (This issue is commonly referred to as the “private benefit” test.)¹⁴⁹

Limitation on lobbying activities

Section 501(c)(3) expressly provides that an organization is not entitled to tax-exempt status under that section unless “no substantial part of the activities of [the organization] is carrying on propaganda, or otherwise attempting, to influence legislation” (commonly referred to as “lobbying”).¹⁵⁰ Thus, public charities may engage in some lobbying activities, provided that

¹⁴⁸ See Haswell v. United States, 500 F.2d 1133, 1142 (Ct. Cl. 1974) (“The applicability of the influencing legislation clause is not affected by the selfish and unselfish motives and interests of the organization, and it applies to all organizations whether they represent private interests or the interests of the public.”); Judith E. Kindell & John F. Reilly, Lobbying Issues, in Continuing Professional Education Exempt Organizations Technical Instruction Program for FY 1997 272 (hereinafter 1997 IRS CPE Text) (finding no distinction between “good” and “bad” legislation).

¹⁴⁹ See American Campaign Academy v. Commissioner, 92 T.C. 1053 (1989) (because the operational test under sec. 501(c)(3) “examines the actual purpose for the organization’s activities and not the nature of the activities or the organization’s statement of purpose,” the court looked beyond the four corners of the organization’s charter to discover “the actual objects motivating the organization” and found that political campaign school had a partisan purpose and the secondary benefit to the Republican entities and candidates was more than incidental); Fund for the Study of Econ. Growth and Tax Reform v. IRS, 997 F. Supp. 15 (D.D.C. 1998) (taking into account “overt partisan statements” of creators of the organization and finding that the organization did not qualify for sec. 501(c)(3) status because it supported a “one-sided political agenda” and, thus, engaged in substantial non-exempt activities), aff’d on other grounds, 161 F.3d 755 (D.C. Cir. 1998). See also Better Business Bureau v. United States, 326 U.S. 279 (1945) (holding that regardless of the number of activities that educated business persons and the general public, organization was not entitled to tax-exempt status as “educational” entity because its “activities are largely animated by a commercial purpose” and “are directed fundamentally to ends other than that of education”); Callaway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978) (organization found to have engaged in substantial nonexempt activities serving private interests by conducting genealogical research focusing on the Callaway family and by urging family members to join by asserting that the organization was “for you, about you”).

¹⁵⁰ See Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983) (holding that restrictions on lobbying activities of charitable organizations are constitutionally

such activities are not substantial, without losing their tax-exempt status and generally without being subject to tax.¹⁵¹ In contrast, private foundations are subject to the restriction that lobbying activities--even if insubstantial so as not to jeopardize the foundation's tax-exempt status--may result in the foundation being subject to penalty excise taxes, unless one of the statutory exceptions contained in section 4945(e) (such as for nonpartisan analysis or self-defense lobbying) apply.

Definition of "lobbying" and "action" organizations

There is no statutory definition under section 501(c)(3) of "propaganda, or otherwise attempting, to influence legislation."¹⁵² However, Treasury regulations provide that an organization is an "action" organization not entitled to tax-exempt status under section 501(c)(3) due to its lobbying activities if a substantial part of the organization's activities is (1) contacting, or urging the public to contact, members of a legislative body for the purpose of proposing, supporting, or opposing legislation; or (2) advocating the adoption or rejection of legislation.¹⁵³ Thus, attempts to influence legislation under section 501(c)(3) include directly contacting members of a legislative body (and their staffs) to propose, support, or oppose legislation (so-called "direct lobbying"), and also include urging the public to contact legislative bodies, or otherwise attempting to influence public opinion, with respect to legislation (so-called "grass roots lobbying"). Except as specifically provided for in Treasury regulations (described below), the IRS takes the position that whether a particular communication constitutes an attempt to influence legislation generally is determined on the basis of the facts and circumstances surrounding the communication in question.¹⁵⁴

For purposes of section 501(c)(3), the term "legislation" includes action by the Congress, by any State legislature, by any local council or similar governing body, or by the public in a referendum, initiative, constitutional amendment, or similar procedure.¹⁵⁵ "Action" by the

valid).

¹⁵¹ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii) provides: "An organization will not fail to meet the operational test merely because it advocates, as an insubstantial part of its activities, the adoption or rejection of legislation."

¹⁵² As discussed infra, there is a statutory definition of "influencing legislation" under section 4911(d) for public charities that make an election under section 501(h) to have their lobbying efforts judged against a sliding-scale, numeric standard.

¹⁵³ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii).

¹⁵⁴ See 1997 IRS CPE Text, supra, at 273.

¹⁵⁵ Treas. Reg. sec. 1.501(c)(3)-1(c)(3)(ii). The IRS has stated that the section 501(c)(3) prohibition on substantial lobbying activities applies to attempts to influence legislation of a foreign country. See Rev. Rul. 73-440, 1973-2 C.B. 177; 1997 IRS CPE Text, supra, at 272.

Congress or by a State legislature or local council refers to introduction, amendment, enactment, defeat, or repeal of Acts, bills, resolutions, or similar items.¹⁵⁶ Contacting executive branch officials generally is not considered lobbying for purposes of section 501(c)(3), unless the charity requests that the executive branch official support or oppose legislation to be considered by a legislative body.¹⁵⁷ Legislation need not actually be formally introduced if a specific legislative proposal is being advocated.¹⁵⁸

Discussions of broad social or public policy issues (without advocating a specific legislative proposal) generally do not constitute attempts to influence legislation for purposes of section 501(c)(3).¹⁵⁹ However, even if a public discussion of broad social or policy issues does not constitute an attempt to influence legislation for purposes of section 501(c)(3), there is still a separate issue of whether the discussion is educational (or furthers some other charitable

¹⁵⁶ See Notice 88-76, 1988-2 C.B. 392. Actions taken by a legislative body with respect to confirmation of a nominee for a public office (e.g., Federal judges) are included within the term “legislation” for section 501(c)(3) purposes, and also may be “exempt function” activities for purposes of the section 527(f) tax. See Announcement 88-114, 1988-37 I.R.B. 26 (Sept. 12, 1988), 1993 IRS CPE Text, *supra*, at 448 n.8 (stating that IRS has made no final determination on the sec. 527 issue), and the discussion below of sec. 527(f)).

¹⁵⁷ See Rev. Rul. 67-293, 1967-2 C.B. 185; 1997 IRS CPE Text, *supra*, at 277.

¹⁵⁸ See Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 1175 (10th Cir. 1972) (urging public to contact legislators to support prayer in school and oppose foreign aid constituted attempts to influence legislation).

¹⁵⁹ See Rev. Rul. 66-256, 1966-2 C.B. 210 (discussion of controversial social and political issues does not disqualify an organization from obtaining tax exemption under sec. 501(c)(3)). A parallel rule for private foundations also exempts from the definition of “lobbying” discussions of broad social, economic, and similar problems, even if the problems are of a type with which the government would be expected to deal ultimately. See Treas. Reg. sec. 53.4945-2(d)(4). Moreover, as discussed below, regulations promulgated under section 4911 provide a similar exception for discussions of broad social and policy issues by public charities making the section 501(h) election, with special rules for certain mass media advertising. See Treas. Reg. secs. 56.4911-2(c)(2) and 56.4911-2(b)(5). Likewise, regulations promulgated under section 162 provide that expenditures for institutional or “good will” advertising--including advertising which keeps the taxpayer’s name before the public and which presents views on economic, financial, social, or other subjects of a general nature--generally are deductible as trade or business expenses rather than being viewed as attempts to influence legislation, provided that such expenditures are related to patronage the taxpayer might reasonably expect in the future. Treas. Reg. sec. 1.162-20(a)(2).

purpose).¹⁶⁰ Thus, if an organization conducts substantial public discussions or disseminates materials concerning broad social or policy issues in a manner that does not further an educational or other exempt purpose, then such activity could jeopardize the organization's tax-exempt status under section 501(c)(3), not because the organization has engaged in substantial lobbying, but rather because it has engaged in substantial activities that do not further an exempt purpose.

Despite this general rule for discussions of broad social issues, Treasury Regulation section 1.501(c)(3)-1(c)(3)(iv) provides for a separate, distinct test under which an organization is treated as an "action organization"--and, thus, not entitled to section 501(c)(3) status--if it has the following two characteristics: (1) its main or primary objective or objectives (as distinguished from its incidental or secondary objectives) may be attained only by legislation or a defeat of proposed legislation; and (2) it advocates, or campaigns for, the attainment of such main or primary objective or objectives as distinguished from engaging in nonpartisan analysis, study, or research and making the results thereof available to the public. In determining whether an organization has such characteristics, all the surrounding facts and circumstances, including the articles and all activities of the organization, are to be considered. In essence, the "action" organization test of Treasury Regulation section 1.501(c)(3)-1(c)(3)(iv) allows substantial lobbying to be found due to the nature of the organization and its aims.¹⁶¹

¹⁶⁰ See, e.g., Nationalist Movement v. Commissioner, 102 T.C. 558 (1994) (holding that the publication of materials advocating social and political change was not "educational" activity under sec. 501(c)(3) because presentation of viewpoints was unsupported by facts, made substantial use of inflammatory and disparaging terms, and expressed conclusions based on emotions rather than objective evaluation), aff'd 37 F.3d 216 (5th Cir. 1994); Rev. Proc. 86-43, 1986-2 C.B. 729 (which describes the so-called "methodology test" for judging whether advocacy of a particular viewpoint is considered "educational" under sec. 501(c)(3)). See also National Alliance v. United States, 710 F.2d 868 (D.C. Cir. 1983) (upholding the denial of tax-exempt status to an organization that published a newsletter promoting racial hatred and violence against minority groups, because the newsletter "cannot reasonably be considered intellectual exposition" and, thus, there was no possibility that it could be found to be "educational within any reasonable interpretation of the term"); Big Mama Rag, Inc. v. United States, 631 F.2d 1030 (D.C. Cir. 1980) (holding that the Treasury regulation that defined "educational" activity as requiring a "full and fair exposition" was unconstitutionally vague and susceptible to discriminatory enforcement). But see National Endowment for the Arts v. Finley, 524 U.S. 569 (1998) (holding that the void-for-vagueness doctrine is not a limitation when government is selecting which types of speech to subsidize).

¹⁶¹ See Fund for the Study of Econ. Growth and Tax Reform v. IRS, 997 F. Supp. 15 (D.D.C. 1998) (finding that two-part test for "action" organization was satisfied because organization conceded that the only way of achieving its policies was through legislative reform, and because press reports and other evidence indicated that the organization "actively engaged in advocacy and furthering a particular political agenda"), aff'd on other grounds, 161 F.3d 755 (D.C. Cir. 1998); Rev. Rul. 62-71, 1962-1 C.B. 85 (research and publications of organization,

Exceptions for non-electing public charities.--Even when a communication refers to a specific legislative proposal (or the organization's primary objective may be attained only by passage or defeat of legislation), the dissemination of nonpartisan analysis or research with respect to a legislative proposal (or the organization's primary objective), without advocating legislative action, is not considered lobbying for purposes of section 501(c)(3).¹⁶² Likewise, responding to a governmental request for testimony is not treated as a lobbying activity.¹⁶³ In addition, advocacy by a charity with respect to legislation that could affect the powers or existence of the organization itself (so-called "self-defense lobbying") generally is considered to be exempt from the section 501(c)(3) lobbying restriction.¹⁶⁴

considered alone, may be educational, but sec. 501(c)(3) status was not available because the organization was primarily involved not only in teaching but in advocating the adoption of a doctrine that could be effective only by enactment of legislation); Roberts Dairy Co. v. Commissioner, 195 F.2d 948 (8th Cir. 1952); 1997 IRS CPE Text, supra, at 276.

¹⁶² See, e.g., Rev. Rul. 64-195, 1964-2 C.B. 138 (organization conducted nonpartisan analysis of a proposed constitutional amendment and disseminated materials to the public, but did not advocate approval or disapproval of the amendment); Rev. Rul. 70-79, 1970-1 C.B. 127 (some of the policies formulated by the organization could be carried out only through legislation, but the organization was entitled to sec. 501(c)(3) status due to the educational nature of its activities and because it did not make any specific legislative recommendations. See also 1997 IRS CPE Text, supra, at 274. As discussed below, a slightly different rule may apply to the nonpartisan analysis exceptions under sections 4911 and 4945, where nonpartisan analysis of a legislative proposal is permitted in order to advocate a particular position or viewpoint, without being treated as lobbying, provided that the communication does not "directly encourage" the recipient to take action within the meaning of Treas. Reg. sec. 56.4911-2(b)(2)(iii)(A)-(C). It remains unclear how the nonpartisan analysis exception for non-electing public charities compares to the nonpartisan analysis exception under sections 4911 and 4945. See Hopkins, Charity, Advocacy, and the Law, supra, at 168 (explaining that it is inadvisable to borrow too heavily from the sec. 4911 rules for nonpartisan analysis when judging activities of non-electing public charities); Miriam Galston, Lobbying and the Public Interest: Rethinking the Internal Revenue Code's Treatment of Legislative Activities, 71 Tex. L. Rev. 1269, 1344-45 n.263 (1993) (noting that the more generous nonpartisan analysis exception of secs. 4911 and 4945 may eventually be applied to non-electing public charities).

¹⁶³ See, e.g., Rev. Rul. 70-449, 1970-2 C.B. 112 (ruling that providing expert testimony to a Congressional committee at the committee's request is not lobbying).

¹⁶⁴ Although there is no precedential ruling from the IRS with respect to self-defense lobbying by a non-electing public charity seeking to protect the organization's own existence or powers under the law, the IRS recognized the self-defense exception in GCM 34289 (May 8, 1970) prior to the enactment of section 501(h). See 1997 IRS CPE Text, supra, at 277 n.20; see also Galston, supra, at 1284 n.40. For the counterpart "self-defense" exceptions for public charities making the 501(h) election, see sec. 4911(d)(2)(C) and Treas. Reg. sec. 56-4911-2(c);

Attribution.--Similar to questions that arise with respect to the political campaign prohibition under section 501(c)(3) (discussed previously), when an individual affiliated with a charity makes a lobbying communication, the question arises whether the lobbying should be viewed as an activity of the individual acting in his or her private capacity or whether the activity should be attributed to the charity. In general, resolution of this issue depends on whether the lobbying activities are within the scope of the individual's authority to act as an agent for the organization (or, if not, whether the organization implicitly ratified the individual's acts).¹⁶⁵ The lobbying activities of a section 501(c)(4) organization will not be attributed to an affiliated charity, so long as the entities are separately incorporated, the records show legally distinct entities, and there are fair-market-value reimbursements for any shared facilities or services.¹⁶⁶ However, because the lobbying restriction is not absolute under section 501(c)(3), a charity may provide some support to lobbying efforts undertaken by another entity, provided that the provision of such support (along with any lobbying activities directly conducted by the charity) does not violate the "substantial part" test (or, sec. 501(h) expenditure limits, if elected by the charity).

Determination of substantiality.--In addition to the definitional question of whether a communication constitutes "lobbying" for purposes of section 501(c)(3), there is a second issue of whether the level of an organization's lobbying activities is "substantial." Except for public charities that make the section 501(h) election (as discussed below), there is no bright-line, mechanical rule for determining whether lobbying activities are substantial relative to the organization's other activities. Rather, the particular facts and circumstances surrounding all activities of the organization (including volunteer time) must be examined. In particular, an arithmetical percentage test (e.g., looking at the percentage of the budget, or employee's time, spent on lobbying) while relevant, has been held not determinative.¹⁶⁷ When Congress enacted section 501(h), it was specifically provided in section 501(h)(7) that the determination of whether the lobbying of a non-electing charity is "substantial" is not affected by the numeric tests

for the counterpart "self-defense" exception for private foundations, see sec. 4945(e) and Treas. Reg. sec. 53-4945-2(d).

¹⁶⁵ See PLR 9507020 (Nov. 17, 1994); 1997 IRS CPE Text, supra, at 277-78.

¹⁶⁶ See 1997 IRS CPE Text, supra, at 337.

¹⁶⁷ See, e.g., Haswell v. United States, 500 F.2d 1133 (Ct Cl. 1974); (holding that an organization's lobbying activities were substantial when roughly 16-20 percent of its expenditures were for lobbying and the organization's lobbying activities were in other respects an important part of its mission); Christian Echoes National Ministry, Inc. v. United States, 470 F.2d 849 (10th Cir. 1972); (rejecting a percentage test in favor of weighing an organization's lobbying activities in light of the organization's overall purposes and activities); and Seasongood v. Commissioner, 227 F.2d 907 (6th Cir. 1955) (deciding that lobbying that accounted for less than 5 percent of an organization's activities is not substantial). See also 1997 IRS CPE Text, supra, at 279-80; Galston, supra, at 1279-80.

provided for by sections 501(h) and 4911 (described below).

Lobbying rules for electing public charities

Section 501(h) election.--Certain public charities may elect under section 501(h) to have the amount of permitted lobbying expenditures measured under the statutory, arithmetical tests set forth in sections 501(h) and section 4911.¹⁶⁸ The arithmetical tests provide an alternative to the imprecise, facts-and-circumstances test of substantiality that otherwise applies to section 501(c)(3) organizations. For a public charity making the section 501(h) election, the allowable amount of lobbying expenditures that can be made for any tax year is determined under a sliding-scale formula. Specifically, the allowable amount of all lobbying (i.e., direct and grass roots lobbying combined) is limited to the sum of (1) 20 percent of the first \$500,000 of the organization's exempt purpose expenditures¹⁶⁹ for the year, (2) 15 percent of the next \$500,000 of such expenditures, (3) 10 percent of the third \$500,000 of such expenditures, and (4) 5 percent of any additional such expenditures. In no event, however, can the allowable amount of lobbying for an organization making the section 501(h) election exceed \$1 million for any year.¹⁷⁰ Grass roots lobbying is subject to a separate limitation, equal to 25 percent of the overall permissible lobbying amount.¹⁷¹ In order to prevent organizations from avoiding the dollar limitations of section 501(h) by dividing themselves into technically separate but related entities, section 4911(f) treats certain affiliated organizations under common control as one organization for purpose of applying the section 501(h) arithmetical tests.¹⁷²

¹⁶⁸ Public charities eligible to make the section 501(h) election include educational institutions, hospitals, and organizations receiving a certain proportion of support from the general public, but not churches and certain church-related entities. Secs. 501(h)(4)-(5). Churches were made ineligible for the section 501(h) election at their own request. See General Explanation of the Tax Reform Act of 1976, supra, at 415.

¹⁶⁹ For this purpose, "exempt purpose expenditures" are defined as expenditures to accomplish the organization's exempt purposes, including properly allocable salary payments, overhead, an allowance for depreciation on a straight-line basis, and all lobbying expenditures, but not including fundraising costs and certain capital expenditures. Sec. 4911(e)(1); Treas. Reg. sec. 56.4911-4.

¹⁷⁰ Sec. 4911(c)(2).

¹⁷¹ Sec. 4911(c)(4). In contrast to the arithmetical test for organizations making the section 501(h) election, the substantial part test for non-electing organizations does not focus solely on expenditures made by the organization and it makes no distinction between direct and grass roots lobbying. See 1997 IRS CPE Text, supra, at 301; Galston, supra, at 1280 (1993) (discussing advantages and disadvantages of sec. 501(h) election for organizations that engage in more grass roots lobbying than direct lobbying or that rely on volunteers for their lobbying).

¹⁷² See Treas. Reg. sec. 56.4911-7.

If the lobbying expenditures (for either all lobbying or grass roots lobbying in particular) of an organization making the section 501(h) election exceed the allowable amounts under section 4911, then an excise tax penalty is imposed on the organization equal to 25 percent of the excess lobbying expenditures.¹⁷³ Imposition of this excise tax penalty under section 4911 may, in some cases, effectively operate as an intermediate sanction short of revocation of the organization's tax-exempt status. However, if the electing organization's lobbying expenditures (for either all lobbying and grass roots lobbying in particular) normally are more than 150 percent of the allowable amounts, then not only will the organization be subject to the excise tax penalties under section 4911, but the organization will lose its tax-exempt status.¹⁷⁴

Definition of lobbying under section 4911.--For purposes of the section 501(h) arithmetical test, lobbying expenditures are defined as "expenditures for the purpose of influencing legislation (as defined in section 4911(d))." Section 4911(d)(1), in turn, defines the term "influencing legislation" as –

(A) any attempt to influence any legislation¹⁷⁵ through an attempt to affect the opinions of the general public or any segment thereof [i.e., "grass roots lobbying communications"], and

(B) any attempt to influence any legislation through communication with any member or employee of a legislative body, or with any government official or employee who may participate in the formulation of the legislation [i.e., "direct lobbying communications"].¹⁷⁶

However, section 4911(d) specifically excludes from the definition of "influencing legislation" the following activities:

¹⁷³ Sec. 4911(a).

¹⁷⁴ Secs. 501(h)(1) and 501(h)(2)(B). The determination of whether an organization's lobbying expenditures normally exceed 150 percent of the allowable amounts generally is made by comparing the sum of the organization's lobbying expenditures for the determination year and the three preceding years to the sum of the allowable lobbying amounts for those years. Treas. Reg. sec. 1.501(h)-3(b).

¹⁷⁵ "Legislation" includes action by legislative bodies but does not include action by "executive, judicial, or administrative bodies." Treas. Reg. sec. 56.4911-2(d)(3). The term "administrative bodies" includes school boards, housing authorities, sewer and water districts, zoning boards, and other similar Federal, State, or local special purpose bodies, whether elective or appointive. Treas. Reg. sec. 56.4911-2(d)(4).

¹⁷⁶ Lobbying with respect to a referendum or ballot initiative subject to a vote by the general public (unless it comes within the nonpartisan analysis exception) is considered "direct lobbying," based on the rationale that, in this context, members of the general public are functioning as legislators. See Treas. Reg. sec. 56.4911-2(b)(1)(iii).

- (A) making available the results of nonpartisan analysis, study, or research;
- (B) providing of technical advice or assistance (where such advice would otherwise constitute the influencing of legislation) to a governmental body or to a committee or other subdivision thereof in response to a written request by such body or subdivision, as the case may be;
- (C) appearances before, or communications to, any legislative body with respect to a possible decision of such body which might affect the existence of the organization, its powers and duties, tax-exempt status, or the deduction of contributions to the organization [i.e., “self-defense direct lobbying”];
- (D) communications between the organization and its bona fide members with respect to legislation or proposed legislation of direct interest to the organization and such members, other than communications [which (1) directly encourage members to contact a legislative body in an attempt to influence legislation, or (2) directly encourage members to urge persons other than members to attempt to affect the opinions of the general public or to contact a legislative body in an attempt to influence legislation]; and
- (E) any communication with a government official or employee, other than –
 - (i) a communication with a member or employee of a legislative body (where such communication would otherwise constitute the influencing of legislation), or
 - (ii) a communication the principal purpose of which is to influence legislation.

With respect to communications with legislators and government officials, Treasury regulations provide a two-part test for determining if such a communication by an organization making the section 501(h) election constitutes a “direct lobbying communication.” Under this two-part test, a communication with a legislator or employee of a legislative body, or with any government official or employee who may participate in the formulation of legislation (provided that the principal purpose of the communication is to influence legislation), will be treated as a “direct lobbying communication” under section 4911 only if the communication both (1) refers to “specific legislation” (meaning legislation that has already been introduced in a legislative body or a specific legislative proposal that the organization either supports or opposes¹⁷⁷), and (2)

¹⁷⁷ “Specific legislation” may be identified by its formal name, by a widely used term in connection with the legislation, or even by its content or effect. See 1997 IRS CPE Text, supra, at 296-97.

reflects a view on such legislation.¹⁷⁸

With respect to communications with the general public, Treasury regulations provide a three-part test for determining whether such a communication by an organization making the section 501(h) election constitutes a “grass roots lobbying communication.” Under this three-part test, a communication with the general public will be treated as a “grass roots lobbying communication” under section 4911 only if the communication: (1) refers to specific legislation; (2) reflects a view on such legislation; and (3) encourages the recipient to take action with respect to the legislation (referred to as a “call to action” requirement) in at least one of four specifically enumerated ways.¹⁷⁹ The first two requirements for “grass roots lobbying communications” generally are interpreted in the same manner as under the two-part test for “direct lobbying” (with an exception described below for certain mass media advertising that is presumed to refer to specific legislation). With respect to the third requirement--i.e., a “call to action”--this requirement is satisfied only if the communication (1) states that the recipient should contact a legislator or an employee of a legislative body, or should contact any other government official or employee (provided that the principal purpose of urging contact with such official or employee is to influence legislation), (2) states the address, telephone number, or similar information of a legislator or employee of a legislative body, (3) provides for a petition, tear-off postcard, or similar material for the recipient to communicate with any legislative or government official, or (4) specifically identifies one or more legislators who will vote on the legislation as: opposing the organization’s view with respect to the legislation; being undecided with respect to the legislation; being the recipient’s representative in the legislature; or being a member of the legislative committee or subcommittee that will consider the legislation.¹⁸⁰ To be considered a “call to action,” a communication must satisfy at least one of these four specific tests enumerated

¹⁷⁸ Treas. Reg. sec. 56.4911-2(b)(1)(ii). The Treasury regulations do not specifically define the term “reflects a view.” Instead, the regulations contain examples that are somewhat conclusory. One example refers to a “position letter” sent to Congress “to gain support” for specific legislation and explains that this constitutes a “direct lobbying communication.” Another example while another example refers to a paper discussing a State’s environmental problems but which “does not reflect a view.” See Treas. Reg. sec. 56.4911-2(b)(4)(I) ex. (1), (3).

¹⁷⁹ Treas. Reg. sec. 56.4911-2(b)(2)(ii).

¹⁸⁰ Treas. Reg. Sec. 56.4911-2(b)(2)(iii). Merely naming the main sponsor(s) of the legislation for purposes of identifying the legislation will not constitute a “call to action.” Id. A communication that merely identifies one or more legislators who will vote on the legislation as supporting the communication’s view (as opposed to identifying legislators as opposing the communication’s view, or as being undecided with respect to the legislation, or as being the recipient’s representative in the legislature) is not a “grass roots lobbying communication” as long as the communication does not include one of the four specific types of “calls to action.” See Treas. Reg. sec. 56.4911-2(b)(4)(ii)(A) ex.7; Hopkins, Charity, Advocacy, and the Law, supra, at 145.

in the Treasury regulations.¹⁸¹ Thus, except in the case of certain mass media advertisements (as described in the following paragraph), no matter how clearly an organization identifies a specific legislative proposal or comments on the merits of that legislation when it communicates with the general public, the absence of a “call to action” means that the communication is not a “grass roots lobbying communication” for purposes of section 4911.¹⁸²

Mass media advertisements.--Under a special rule contained in the section 4911 regulations, certain mass media advertisements that otherwise do not satisfy the three-part test for a “grass roots lobbying communication” may nevertheless be treated as “grass roots lobbying communications.” Under this special rule, if, within two weeks before a vote by a legislative body or committee (but not subcommittee) on “highly publicized”¹⁸³ legislation, a paid advertisement appears in the mass media (i.e., television, radio, billboards and certain general circulation newspapers and magazines¹⁸⁴), then such an advertisement will be presumed to be a “grass roots lobbying communication” if it (1) reflects a view on the general subject of such legislation, and (2) either refers to the highly publicized legislation or encourages the public to communicate with legislators on the general subject of such legislation. Treas. Reg. sec. 56.4911-2(b)(5).¹⁸⁵ This presumption may be rebutted if the organization demonstrates that the advertisement is a type of mass media communication regularly made by the organization (without regard to the timing of the legislation) or that the timing of the advertisement was unrelated to the upcoming legislative action. If a mass media advertisement falls outside the special rule of Treasury regulation sec. 56.4911-2(b)(5), or if the special rule applies but the

¹⁸¹ See 1997 IRS CPE Text, *supra*, at 300-301 (an exhortation to the public to “oppose” a particular legislative proposal is not, by itself, a “call to action” under sec. 4911).

¹⁸² See *id.* at 298-299.

¹⁸³ Treas. Reg. sec. 56.4911-2(b)(5)(iii)(C) provides that “highly publicized” means frequent coverage on television and radio, and in general circulation newspapers, during the two weeks preceding the vote by the legislative body or committee. However, the regulation goes on to state that, even where legislation receives frequent coverage, it is “highly publicized” only if “the pendency of the legislation or the legislation’s general terms, purpose, or effect are known to a significant segment of the general public (as opposed to the particular interest groups directly affected) in the area in which the paid mass media advertisement appears.” *Id.*

¹⁸⁴ Where an electing organization is itself a mass media publisher or broadcaster, all portions of that organization’s mass media publications or broadcasts are treated as paid advertisements in the mass media, except those specific portions that are advertisements paid for by another person. Treas. Reg. sec. 56.4911-2(b)(5)(iii)(B).

¹⁸⁵ See 1997 IRS CPE Text, *supra*, at 308-09 (noting that presumption does not apply if an advertisement appears even one day more than two weeks before a vote; nor does the presumption apply if public pressure from an advertising campaign results in a scheduled vote being canceled).

presumption is rebutted, then the general three-part test applies for determining whether the advertisement constitutes a “grass roots lobbying communication.”

Discussions of broad social issues.--Consistent with the definitions of “direct lobbying communications” and “grass roots lobbying communications” under section 4911, Treasury regulations provide that “[e]xaminations and discussions of broad social, economic, and similar problems are neither direct lobbying communications under section 56.4911-2(b)(1) nor grass roots lobbying communications under section 56.4911-2(b)(2) even if the problems are of the type with which government would be expected to deal ultimately.” Treas. Reg. sec. 56.4911-2(c)(2).¹⁸⁶ Consequently, lobbying communications do not include public discussion, or communications with members of legislative bodies or governmental employees, the general subject of which is also the subject of legislation before a legislative body, so long as such discussion does not address itself to the merits of a specific legislative proposal and so long as such discussion does not directly encourage recipients to take action with respect to legislation. Id.¹⁸⁷ This treatment of discussions of broad social and policy issues is implicit in the two-part definition of “direct lobbying” and the general three-part definition of “grass roots lobbying,” because both definitions require that the communication in question “reflects a view” on a specific legislative proposal (and the general definition of “grass roots lobbying communication” under section 4911 further requires that there be a specific “call to action”).¹⁸⁸ Moreover, if a mass media advertisement appearing within two weeks of a vote reflects a view on a general social or policy issue that also is the subject of highly publicized legislation, then the advertisement could be presumed to be a grass roots lobbying communication only if the advertisement also refers to specific legislation or encourages the public to communicate with legislators on the general social or policy issue. Thus, if there is neither a reference to specific

¹⁸⁶ The counterpart regulation for private foundations is Treas. Reg. sec. 53.4945-2(d)(4).

¹⁸⁷ For example, Treas. Reg. sec. 56.4911-2(b)(4)(ii)(a) ex.4, points out that an organization could encourage members of the public to send their legislators a coupon to “support a drug free America” without referring to any specific legislation, and this would not be treated as a “grass roots lobbying communication” under the general three-part test. However, if such a communication appeared in a paid mass media advertisement within two weeks of a vote on highly publicized legislation concerning drug abuse, then such a communication potentially could be presumed to be a “grass roots lobbying communication” under Treas. Reg. sec. 56.4911-2(b)(5).

¹⁸⁸ See 1997 IRS CPE Text, supra, at 306 n.37 (noting that the exception in the sec. 4911 regulations for discussion of broad social problems was included to provide parity with a pre-existing exception under sec. 4945, but, as a substantive matter, the exception is “superfluous” given the definitions of lobbying communications in the sec. 4911 regulations). See also James J. McGovern et al., The Revised Lobbying Regulations--A Difficult Balance, 41 Tax Notes 1245 (1988) (“[T]he revised definition of grass roots lobbying will reduce or eliminate the need for organizations to depend upon the exception for discussion of broad social, economic, and similar problems.”)

legislation nor a mass media “call to action” regarding the general social or policy issue that is also the subject of legislation that is voted on within two weeks, then the public discussion of broad social or policy issues is not a lobbying communication under section 4911.¹⁸⁹

Statutory exceptions under section 4911.--Even if a communication by an organization meets the definition of a “direct lobbying” or “grass roots lobbying” communication under the general rules described above, the communication nonetheless may be exempt if one of the five statutory exceptions of section 4911(d)(2) apply. The first of these statutory exceptions is “making available the results of nonpartisan analysis, study, or research.”¹⁹⁰ With respect to this exception, Treasury Regulation section 56.4911-2(c)(1)(ii) provides that the term “nonpartisan analysis, study, or research” means “an independent and objective exposition of a particular subject matter, including any activity that is ‘educational’ within the meaning of [Treasury Regulation] section 1.501(c)(3)-1(d)(3).”¹⁹¹ Treasury Regulation section 56.4911-2(c)(1)(ii) goes

¹⁸⁹ As discussed previously, whether or not the discussion is conducted in a manner that furthers an educational or other exempt purpose (or violates the private benefit test) is a separate question.

¹⁹⁰ Sec. 4911(d)(2)(A).

¹⁹¹ Treas. Reg. sec. 1.501(c)(3)-1(d)(3) provides that “an organization may be educational even though it advocates a particular position or viewpoint so long as it presents a sufficiently full and fair exposition of the pertinent facts as to permit an individual or the public to form an independent opinion or conclusion.” In Rev. Proc. 86-43, 1986-2 C.B. 729 (which was issued to address the vagueness concerns identified in the Big Mama Rag decision, discussed above), the IRS indicated that its focus in applying Treas. Reg. sec. 1.501(c)(3)-1(d)(3) is not on the viewpoint or position advocated, but rather on the method used by the organization to communicate its viewpoint. Rev. Proc. 86-43 indicates that the method used by the organization “will not be considered educational if it fails to provide a factual foundation for the viewpoint or position being advocated, or if it fails to provide a development from the relevant facts that would materially aid a listener or reader in a learning process.” Further, Rev. Proc. 86-43 indicates that the presence of any of the following factors in the presentations made by an organization is indicative that the method used by the organization to advocate its views is not educational: (1) the presentation of viewpoints unsupported by facts is a significant portion of the organization’s communications; (2) the facts that purport to support the viewpoints or positions are distorted; (3) the organization’s presentations make substantial use of inflammatory and disparaging terms and express conclusions more on the basis of strong emotional feelings than of objective evaluations; and (4) the approach used in the organization’s presentations is not aimed at developing an understanding on the part of the intended audience or readership because it does not consider their background or training in the subject matter. However, Rev. Proc. 86-43 goes on to provide that, even if one or more of the above four factors are present, the IRS will look to all facts and circumstances to determine whether an organization nonetheless may be considered “educational.” An examination of the factors listed in Rev. Proc. 86-43 is commonly referred to as the “methodology test.” See Nationalist Movement v. Commissioner, 102 T.C. 558 (1994)

on to provide: “Thus, ‘nonpartisan analysis, study, or research’ may advocate a particular position or viewpoint so long as there is a sufficiently full and fair exposition of the pertinent facts to enable the public or an individual to form an independent opinion or conclusion. The mere presentation of unsupported opinion, however, does not qualify as ‘nonpartisan analysis, study, or research.’”¹⁹²

Treasury Regulations provide that nonpartisan analysis that reflects a view on specific legislation is not within the section 4911(d)(2)(A) exception if the communication “directly encourages” the recipient to take action--meaning that the communication expressly states that the recipient should contact a legislative or government official or employee, includes the address, telephone number or similar information of a such official or employee, or includes a petition tear-off postcard, or similar material for the recipient to send to such an official or employee. However, nonpartisan analysis within the section 4911(d)(2)(A) exception is allowed to include a limited (or implicit) “call to action” that specifically identifies one or more legislators who will vote on the legislation as (1) opposing the organization’s views with respect to the legislation, (2) being undecided with respect to the legislation, (3) being the recipient’s representative in the legislature, or (4) being a member of the legislative committee or subcommittee that will consider the legislation.¹⁹³

Under section 4911(d)(2)(A), an organization may choose any suitable means, including oral or written presentations or disseminations to the news media, to distribute its nonpartisan analysis or research. However, communications may not be limited to, or be directed toward, persons who are interested solely in one side of a particular issue (Treas. Reg. sec. 56.4911-2(c)(1)).¹⁹⁴

(upholding the constitutionality of the methodology test), aff’d 37 F.3d 216 (5th Cir. 1994).

¹⁹² As discussed in more detail below, it is not clear whether the IRS intends to use the arguably stricter “full and fair exposition” test with respect to advocacy involving legislation, or whether satisfying the “methodology” test of Rev. Proc. 86-43 (which can be viewed as a subset of the “full and fair exposition” test) would suffice, even if both sides of the debate on a legislative issue are not presented. It is also questionable whether use of the “full and fair exposition” test (without the overlay provided by the “methodology” test) for judging advocacy with respect to legislation would be constitutionally permissible in view of the Big Mama Rag decision. But see Nat’l Endowment for the Arts v. Finley, 524 U.S. 569 (1998). Compare Nationalist Movement v. Commissioner, 102 T.C. at 587 n.17 (noting that it is doubtful that the IRS could require the presentation of opposing views) with Fund for the Study of Econ. Growth & Tax Reform v. I.R.S. 997 F. Supp. 15 (D.D.C. 1998) (finding that the organization did not conduct nonpartisan analysis, but the court did not refer to either the “full and fair exposition” test or the “methodology” test), 161 F.3d 755 (1998).

¹⁹³ Treas. Reg. secs. 56.4911-2(b)(2)(iii) and 56.4911-2(c)(1)(vi).

¹⁹⁴ See 1997 IRS CPE Text, *supra*, at 302-03.

The four additional statutory exceptions provided for by section 4911(d)(2) include (1) providing technical advice or assistance upon written request from a governmental body,¹⁹⁵ (2) so-called self-defense direct lobbying--that is, communications with a legislative body with respect to a possible decision by the body which might affect the existence of the organization, its powers and duties, or its tax-exempt status, or the deduction of contributions to the organization,¹⁹⁶ (3) communications between an organization and its bona fide members, provided that the communication does not directly encourage the members to contact legislators or to urge nonmembers to influence legislation,¹⁹⁷ and (4) communications with government officials or employees, provided that the communication is not a direct lobbying communication with a member or employee of a legislative body and, in the case of other government officials, does not have the principal purpose of influencing legislation.¹⁹⁸

Cost allocations.--In addition to defining direct and grass roots lobbying communications and the five statutory exceptions, Treasury regulations issued under section 4911 provide detailed guidance for allocating particular expenditures to lobbying communications. In general, public charities making the section 501(h) election are required to treat as lobbying expenditures all

¹⁹⁵ Under this exception, the request for assistance or advice must be made in the name of the requesting governmental body, committee, or subdivision rather than an individual member thereof; and the response to such request must be made available to every member of the requesting body, committee, or subdivision. Treasury regulations further provide that because such assistance or advice may be given only at the express request of a governmental body, the oral or written presentation of such assistance or advice need not qualify as nonpartisan analysis, study or research. The offering of opinions or recommendations will ordinarily qualify under this exception only if such opinions or recommendations are specifically requested by the governmental body or are directly related to the materials so requested. See Treas. Reg. secs. 56.4911-2(c)(3) and 53.4945-2(d)(2).

¹⁹⁶ See Treas. Reg. secs. 56.4911-2(c)(4) and 53.4945-2(d)(3); 1997 IRS CPE Text, supra, at 307-08.

¹⁹⁷ Treas. Reg. sec. 56.4911-5. For purposes of this exception, the term “directly encourage” has the same meaning as for the nonpartisan analysis exception. See Treas. Reg. sec. 56.4911-5(f)(6); 1997 IRS CPE Text, supra, at 314-17. A communication between an organization and a member of the organization which directly encourages the member to engage in direct lobbying of a member or employee of a legislative body is considered a direct lobbying communication (unless the self-defense exception applies). See sec. 4911(d)(3)(A); Treas. Reg. sec. 56.4911-5(f)(6)(B).

¹⁹⁸ When a communication is with government official or employee who is not a member of (or employed by) a legislative body, then the costs of the communications are taken into account under section 4911 only if the principal purpose of the communication is to influence legislation. See General Explanation of Tax Reform Act of 1976, supra, at 410.

direct costs of producing the communication, as well as an allocable share of overhead costs.¹⁹⁹ In addition, rules are provided for so-called “mixed purpose” expenditures and for allocating costs when non-lobbying materials (e.g., nonpartisan analysis) subsequently are used by an organization as part of a grass roots lobbying campaign.²⁰⁰

Penalties applicable to private foundations.--For purposes of determining whether a private foundation should have its exemption revoked, the substantial part test under section 501(c)(3) continues to apply. As a separate issue, private foundations and their managers are potentially subject to excise taxes under section 4945 (as described above), if any expenditures are made for either direct or grass roots lobbying. Lobbying activities may be subject to tax under section 4945 even in cases where such activities are not substantial relative to the private foundation’s other activities.²⁰¹ For purposes of section 4945, lobbying is defined in a manner similar to the definition under section 4911(d). Specifically, as under section 4911(d)(2), the section 4945 penalty excise taxes do not apply to (1) making available the results of nonpartisan analysis, study, or research, (2) providing technical advice to a governmental body in response to a written request, or (3) direct lobbying of a legislative body with respect to a possible decision of such body which might affect the existence of the private foundation, its powers and duties, its tax-exempt status, or the deduction of contributions to such foundation.²⁰²

Penalties applicable to public charities.--For public charities making the section 501(h) election, there is an intermediate sanction of an excise tax penalty that may be imposed in cases in which an organization exceeds the so-called “lobbying nontaxable amount” (or “grass roots nontaxable amount”) but the organization does not normally exceed the numeric limits by more than 150 percent.²⁰³ In cases in which the electing public charity does not normally exceed the

¹⁹⁹ Treas. Reg. sec. 56.4911-3(a)(1).

²⁰⁰ Treas Reg. secs. 56.4911-2(b)(2)(v) and 56.4911-3(a)(2); 1997 IRS CPE Text, supra, at 304-06. See also Hopkins, Charity, Advocacy, and the Law, supra, at 155-57.

²⁰¹ Id. at 49. Although the section 4945 excise tax conceptually could be viewed by private foundations as a “cost of doing business” in situations where the foundation wants to engage in insubstantial lobbying (without meeting one of the statutory exceptions), private foundations generally have not adopted this view. See Galston, supra, at 1278 n.21. In theory, a willful and flagrant lobbying expenditure that leads to imposition of a penalty excise tax under section 4945 also could lead to termination of a private foundation’s tax-exempt status due to the operation of section 507(a)(2), even though the lobbying activity might not be “substantial” under section 501(c)(3).

²⁰² Sec. 4945(e). In contrast to section 4911(d)(2), there is no explicit exception under section 4945(e) for membership communications, because private foundations generally do not have members.

²⁰³ Sec. 501(h)(1).

lobbying nontaxable amount by more than 150 percent, an excess tax penalty may be imposed under section 4911, but the charity's tax-exempt status may not be revoked due to the lobbying activity. In contrast, for non-electing public charities, there is no excise tax penalty that can be imposed as an intermediate sanction (i.e., in lieu of revocation of the organization's tax exempt status) due to the charity's lobbying activities. In 1987, Congress enacted section 4912, which provides for the imposition of penalty excise taxes due to improper lobbying expenditures made by a non-electing public charity (other than a church). However, the section 4912 excise taxes may be imposed only if the charity ceases to qualify for tax-exempt status under section 501(c)(3) due to its substantial lobbying activities.²⁰⁴ Section 4912 imposes on such a disqualified organization an excise tax equal to five percent of the amount of lobbying expenditures incurred during the year in which the organization has ceased to qualify under section 501(c)(3) due to making lobbying expenditures. Organization managers who, without reasonable cause, agree to make lobbying expenditures knowing that they are likely to result in revocation of the organization's tax-exempt status under section 501(c)(3) also are subject to an excise tax equal to five percent of such lobbying expenditures.

A section 501(c)(3) organization also may be subject to an excise tax under section 527(f) (discussed in greater detail below) if the organization engages in activity which is "exempt function" activity under section 527 -- broadly meaning attempts to influence the selection of any individual to public office -- even though such activity is not prohibited political campaign intervention under section 501(c)(3) (e.g., attempts by section 501(c)(3) organizations to influence appointments to nonelected public office, such as Supreme Court appointments).²⁰⁵

There is no rule preventing an organization that loses its tax-exempt status under section 501(c)(3) because it engages in substantial lobbying (or normally exceeds the section 501(h) ceiling) from applying for restoration of its section 501(c)(3) status in a subsequent taxable year, at which time the organization will again be subject to the lobbying limitation.²⁰⁶ However, a charitable organization (other than a church) that loses its tax-exempt status under section 501(c)(3) because of excessive lobbying activities may not attempt to thereafter escape the lobbying limitation by being treated as a tax-exempt social welfare organization under section 501(c)(4).²⁰⁷

²⁰⁴ See H.R. Conf. Rep. No. 100-495, at 1023 (1987).

²⁰⁵ See Announcement 88-114, 1988-37 I.R.B. 26 (Sept. 12, 1988) (proposing that attempts to influence confirmation of a federal judicial nominee, or other nominee to a nonelective public office, constitute an "exempt function" under sec. 527(e)(2), and soliciting comments from the public on this issue). But see 1993 IRS CPE Text, supra, at 448 n.8 (noting that no final determination has been made of this issue).

²⁰⁶ See General Explanation of the Tax Reform Act of 1976, supra, at 414.

²⁰⁷ Sec. 504(a)(2)(A).

Other organizations

Section 501(c) organizations (other than charities described in section 501(c)(3)) are not subject to any specific provision that restricts their lobbying activities. In general, the only limit imposed by the Internal Revenue Code is that the lobbying activities must be germane to the accomplishment of the organization's exempt purposes. For some organizations, such as social welfare organizations or business leagues, lobbying may be the organization's primary, or even sole, activity.²⁰⁸ It is not uncommon for organizations such as social welfare organizations, labor organizations, and business leagues to conduct substantial lobbying as their primary activity. However, as discussed below, some lobbying activities (i.e., attempts to influence the selection of an individual to a non-elective public office) potentially could lead to the imposition of tax under section 527(f).

2. Section 527 political organizations

In general

Section 527 provides a limited tax-exempt status to "political organizations," meaning a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures (or both) for an "exempt function".²⁰⁹ For purposes of section 527, the term "exempt function" means: "the function of influencing or attempting to influence the selection, nomination, election or appointment of any individual to any Federal, State, or local public office or office in political organization, or the election of Presidential or

²⁰⁸ See Rev. Rul. 71-530, 1971-2 C.B. 237; Rev. Rul. 61-177, 1961-2 C.B. 117; 1997 IRS CPE Text, *supra*, at 261. As discussed above, tax-exempt trade associations and certain other tax-exempt organizations (but not charities described in section 501(c)(3)) generally are required to provide annual information disclosure to members estimating the portion of their dues allocable to lobbying activities, and to political campaign activities, as defined under section 162(e)(1). Sec. 6033(e). Some organizations, such as section 501(c)(19) veterans groups, can engage in virtually unlimited lobbying. See Regan v. Taxation With Representation of Washington, 461 U.S. 540 (1983). Section 501(c)(12) cooperatives and section 501(c)(14) credit unions may lobby as an incidental part of providing their services. Section 501(c)(7) social clubs also may lobby if it furthers their recreational or other non-profitable purposes. Arguably, substantial lobbying--other than self-defense lobbying--by some tax-exempt organizations could violate the terms of their exemption that they be organized and operated "exclusively" for certain narrow purposes enumerated by statute. See Galston, *supra*, at 1276-77 n.18.

²⁰⁹ Sec. 527(e)(1). A political organization for purposes of section 527 need not be formally organized as a separate legal entity. A separate bank account in which political campaign funds are deposited and disbursed for political campaign expenses can qualify as a political organization. See Rev. Rul. 79-11, 1979-1 C.B. 207. A separate statutory rule provides section 527 status to certain newsletter funds. Sec. 527(g).

Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed".²¹⁰

The facts and circumstances of each case determine whether a particular Federal, State, or local office is a "public office" for purposes of section 527, although the focus usually is upon whether a significant part of the activities of the office consist of the independent performance of policy-making functions.²¹¹ "Exempt function" activities for purposes of section 527 include not only attempts to influence voting with respect to elective public or political offices but also may include attempts to influence selections or appointments of individuals to non-elective public or political offices. If so, the scope of "exempt function" activities under section 527 would be broader than the "political campaign" activities that are impermissible for section 501(c)(3) organizations.²¹²

Limited tax exemption under section 527

Section 527 exempts from taxation certain "exempt function income" (i.e., contributions, dues, proceeds from political fundraisers or the sale of campaign materials, and proceeds from bingo games) but only to the extent such income is segregated for use only for an "exempt function" of a political organization.²¹³ Thus, no entity-level income tax is imposed on contributions (and certain other "exempt function" income) received by a political organization which are used for electioneering or other "exempt function" activities (as defined in section

²¹⁰ Sec. 527(e)(2). The term "exempt function" also includes the making of expenditures relating to a Federal, State, or local public office or office in a political organization which, if incurred by the individual occupying that office, would be allowable as a trade or business expense deduction under section 162(a). Sec. 527(e)(2).

²¹¹ See Treas. Reg. secs. 1.527-2(d) and 53.4946-1(g)(2).

²¹² See Notice 88-76, 1988-2 C.B. 392, and Announcement 88-114, 1988-37 I.R.B. 26 (Sept. 12, 1988). Treas. Reg. 1.527-6(b)(4) suggests that attempts to influence appointments to nonelected public offices generally are "exempt function" activities under section 527, by providing a specific exemption for an appearance by section 501(c) organization before a legislative body in response to a written request for the purpose of influencing the appointment or confirmation of an individual to a public office. But see 1995 ABA Comments, supra, at 31 (arguing that "exempt function" under sec. 527(e)(2) should be interpreted as not applying to activities to influence selections to non-elected public offices). In this regard, it should be noted that the Senate passed an amendment to the Technical and Miscellaneous Revenue Act of 1988, which would have statutorily provided that attempts to influence the selection of an individual to a non-elected public office are not "exempt function" activities for purposes of section 527(f). In conference, this provision was dropped from the 1988 Act.

²¹³ See secs. 527(c)(1)(A) and 527(c)(3); Treas. Reg. sec. 1.527-3 (providing examples of exempt function income).

527).²¹⁴ However, a political organization's investment income and any other non-exempt function income (e.g., income from events that are not political in nature),²¹⁵ minus expenses directly connected with the production of such income,²¹⁶ is subject to tax at the highest corporate income tax rate (currently 35 percent).

Amounts expended by a political organization described in section 527 for an exempt function are not income to the individual (i.e., the candidate) on whose behalf such expenditures are made. However, if a political organization expends any other amount for the personal use of any individual (e.g., if a political organization pays a personal legal obligation of the candidate), the individual on whose behalf the amount is expended must include such amount in his or her gross income.²¹⁷ Excess funds controlled by a political organization after a campaign are includible in the gross income of the person having control over the ultimate use of such funds, unless the funds are transferred to another political organization (or to certain public charities or governmental general funds) within a reasonable period of time or are held in reasonable anticipation of being used for a future campaign.²¹⁸

Gift tax implications

Contributions to political organizations described in section 527 are specifically

²¹⁴ Expenses incurred in conducting an "exempt function" activity under section 527 may be either directly or indirectly related to such activity, including expenses related to activities engaged in between elections to support the next political campaign and fundraising activities. See Treas. Reg. sec. 1.527-2(c). As one example, Treasury regulations provide that expenses for voice and speech lessons to improve a candidate's skills are for an "exempt function" (Treas. Reg. sec. 1.527-2(c)(5)(iii)). See also Rev. Rul. 79-13, 1979-1 C.B. 208 (expenses for voter research and public opinion polls are "exempt function" expenses under sec. 527, provided that there is a nexus with an election). An "exempt function" also generally includes an activity which is in furtherance of the process of terminating a political organization's existence. See Treas. Reg. sec. 1.527-2(c)(3).

²¹⁵ See Treas. Reg. sec. 1.527-3(d); Rev. Rul. 80-103, 1980-1 C.B. 120 (income of political organization from sale of art reproductions was not exempt function income for purposes of sec. 527). See also 1993 IRS CPE Text, supra, at 458-59.

²¹⁶ See Treas. Reg. sec. 1.527-4(c). In computing taxable income, a political organization is allowed a specific deduction of \$100 under section 527(c)(2)(A).

²¹⁷ See Treas. Reg. sec. 1.527-5(a)(1). If a political organization contributes any amount to any other political organization, to or for the use of certain public charities, or to the general fund of the Federal, State, or local government, then such amount will not be treated as expended for the personal use of the candidate or any other person. Treas. Reg. sec. 1.527-5(b).

²¹⁸ Treas. Reg. sec. 1.527-5(c)(1).

exempted from the Federal gift tax.²¹⁹ Contributions to charities are likewise exempt from the Federal gift tax, but there is no similar statutory exemption from the Federal gift tax for contributions to social welfare organizations described in section 501(c)(4).²²⁰

Disparity between definition of “exempt function” activities under section 527 and Federal election law “express advocacy” standard

In determining whether a particular activity is an “exempt function” activity under section 527, the IRS examines all relevant facts and circumstances to determine the relationship (that is, whether there is a nexus) between the activity and the statutory definition of “influencing or attempting to influence” the election of an individual to a public or political office.²²¹ Generally, expenditures incurred for any activity that supports an individual’s campaign are treated as an “exempt function” expenditure under section 527,²²² regardless of whether the particular activity

²¹⁹ Sec. 2501(a)(5). A special rule provides, however, that the contributor’s gross income for income tax purposes will include the built-in gain in any appreciated property contributed to political organizations. Sec. 84.

²²⁰ Sec. 2522(a)(2). See Rev. Rul. 82-216 C.B. 1982-1 C.B. 220 (“The Service continues to maintain that gratuitous transfers to persons other than organizations described in section 527(e) of the Code are subject to the gift tax absent any specific statute to the contrary, even though the transfers may be motivated by a desire to advance the donor’s own social, political, or charitable goals.”) However, with respect to political contributions made prior to the enactment of sections 527 and 2501(a)(5) in 1974, two courts held that such contributions were not within the purview of the Federal gift tax regime. See Carson v. United States, 641 F.2d 864 (10th Cir. 1981); Stern v. United States, 436 F.2d 1327 (5th Cir. 1971). The rationale reflected in the Carson and Stern decisions--i.e., that the recipient organization or candidate may be viewed for gift tax purposes as a means to the end of the contributor--arguably could be applied to contributions made to fund advocacy activities (“express advocacy” or “issue advocacy”) of section 501(c)(4) organizations.

²²¹ See 1993 IRS CPE Text, supra, at 448-49; TAM 9320002 (Jan. 14, 1993). See generally Milton Cerny and Frances R. Hill, Political Organizations, 13 Exempt. Org. Tax Review 591, 596-97 (1996) (explaining that the determination of whether a particular expenditure constitutes an “exempt function” expenditure depends on whether there is a nexus with an election, nomination, or selection process, based on an examination of the facts and circumstances of each case, and does not depend on any intrinsic qualities of the event at which expenditures are incurred).

²²² See TAM 9130008 (April 16, 1991) (ruling that distributing campaign material promoting a statewide referendum, which displayed a candidate’s name and picture and identified him as a leader on the issue, but did not specifically mention his candidacy since he was not an announced candidate at the time, was “exempt function” activity under sec. 527).

involves “express advocacy” as that term is defined for Federal election law purposes.²²³ For purposes of section 527, “exempt function” expenditures need not be related to a particular candidate or office holder’s campaign, but can relate to attempts to influence voting on multiple (announced or unannounced) candidates.²²⁴

In a series of recent private letter rulings (“PLRs”), the IRS has recognized the “political organization” status under section 527 of organizations that are specifically prohibited (either by their charter or by a resolution adopted by their board of directors) from expressly advocating the election or defeat of any particular candidate.²²⁵ In these private letter rulings, the organizations represented that their primary activity would be conducting voter education efforts and grass roots lobbying (commonly referred to as “issue advocacy”), the content, timing, and geographic targeting of which was intended to influence recipients to favor the organization’s view when voting for candidates. The IRS ruled that, because such biased voter education activities constituted political campaign intervention under long-standing interpretations of section

²²³ Although some uncertainty remains, courts generally have held that only communications that contain express words advocating the election or defeat of a political candidate--so-called “express advocacy”--are subject to the requirements of the Federal Election Campaign Act (FECA), which includes restrictions on contributors who are eligible to fund such communications (i.e., corporations, unions, and foreign persons are prohibited from making contributions), dollar contribution limits for individual contributors, and public disclosure requirements for funds raised and spent for such communications. See Federal Election Commission v. Massachusetts Citizens for Life, Inc., 479 U.S. 238 (1986); Maine Right to Life Committee v. Federal Election Commission, 98 F.3d 1 (1st Cir. 1996); Federal Election Commission v. Christian Action Network, 110 F.3d 1049 (4th Cir. 1997). But see Federal Election Commission v. Furgatch, 807 F.2d 857 (9th Cir. 1987); FEC regulation 11 C.F.R. sec. 100.22 (1995) (providing that “express advocacy” includes communications which, when taken as a whole, reasonable persons could not differ as to whether it encourages actions to elect or defeat a clearly identified candidate). Communications that fall outside of the FECA definition of “express advocacy” are commonly referred to as “issue advocacy.” See generally CRS, Campaign Finance Reform: A Legal Analysis of Issue and Express Advocacy (98-282A, updated May 15, 1998); CRS, Soft and Hard Money in Contemporary Elections: What Federal Law Does and Does Not Regulate (97-91 GOV, Jan. 10, 1997). Nevertheless, communications that constitute unregulated “issue advocacy” for FECA purposes may constitute “exempt function” activities for purposes of section 527. In addition, whereas FECA applies only to Federal elections, section 527 applies to attempts to influence elections of individuals to Federal, State, or local public offices.

²²⁴ See Treas. Reg. sec. 1.527-2(c)(5)(viii) ex.8; 1993 IRS CPE Text, supra, at 449-51.

²²⁵ See PLR 9808037 (Nov. 21, 1997); PLR 9725036 (March 24, 1997); PLR 9652026 (Oct. 1, 1976).

501(c)(3), such activities were, in turn, “exempt function” activities under section 527.²²⁶ The organizations themselves sought section 527 status, apparently to clarify that their donors would be immune from Federal gift tax liability, while simultaneously preserving the organization’s ability to assert (for non-tax purposes) that their implied approval or disapproval of candidates was beyond the reach of the Federal election laws.²²⁷

Other tax-exempt organizations

Section 527(f) provides that if any tax-exempt organization described in section 501(c) makes expenditures for an “exempt function” activity (within the meaning of sec. 527(e)(2)), then the organization’s net investment income, up to the amount of the “exempt function” expenditures, will be subject to tax (at the highest corporate income tax rate). For purposes of section 527(f), a separate segregated fund (meeting certain criteria) maintained by a section 501(c) organization is treated as a separate organization.²²⁸

The provisions of subsection 527(f) operate to ensure that tax-free investment income of a tax-exempt organization described in section 501(c) is not used to pay for "exempt function" activities within the meaning of section 527. In this way, section 527 political organizations and section 501(c) organizations receive similar treatment with respect to their electioneering activities. The section 527(f) tax applies regardless of whether there is any direct tracing of the section 501(c) organization’s investment income to “exempt function” expenditures within the meaning of section 527.²²⁹ As a result, section 527 "exempt function" activities cannot be directly or indirectly subsidized with tax-free investment income.²³⁰

²²⁶ In PLR 9808037 (Nov. 21, 1997), the IRS stated: “It follows that any activities constituting prohibited political intervention by a section 501(c)(3) organization are activities that must be less than the primary activities of a section 501(c)(4) organization, which are, in turn, activities that are exempt functions for a section 527 organization.” See also PLR 1999-25051 (March 29, 1999).

²²⁷ See sec. 2501(a)(5).

²²⁸ Sec. 527(f)(3).

²²⁹ Any investment income of a section 501(c) organization that already is subject to unrelated business income tax is disregarded so that it is not subject to double taxation. Sec. 527(f)(2).

²³⁰ However, section 527(f) does not, in all situations, prevent other tax-free monies from being used to subsidize "exempt function" activities within the meaning of section 527. For instance, a section 501(c)(3) charity which has no (or insignificant) investment income could use tax-deductible charitable contributions (assuming that the contributions were not earmarked for lobbying) to finance attempts to influence a judicial nomination, which may be an “exempt function” activity under section 527. As another example, a nonprofit organization that is

The same definition of "exempt function" provided for in section 527(e)(2) generally applies for purposes of defining both the permissible tax-free activities of political organizations and the activities of 501(c) organizations which may result in imposition of tax under section 527(f). However, Treasury regulations specifically provide that, in the case of a tax-exempt organization described in section 501(c), expenditures for nonpartisan voter registration and "get-out-the-vote" campaigns not specifically identified with any candidate or political party do not constitute "exempt function" expenditures and, thus, will not lead to tax under section 527(f).²³¹ Treasury regulations also provide that when a tax-exempt organization described in section 501(c) appears before any legislative body in response to a written request by such body for the purpose of influencing the appointment or confirmation of an individual to a public office, any expenditure directly related to such appearance is not treated as an "exempt function" expenditure under section 527.²³² In addition, expenditures made by a section 501(c) organization which are otherwise allowable under the Federal Election Campaign Act (FECA) or similar State statute are treated as being incurred for an "exempt function" only to the extent

exempt from the section 6033(e) flow-through information disclosure and proxy-tax requirements (because substantially all dues paid to the organization are not deductible to the payor) may receive dues from a small fraction of its members who, in fact, deduct such dues as a trade or business expense. If such an organization makes "exempt function" expenditures within the meaning of section 527 in excess of its net investment income, then some of the excess "exempt function" expenditures could be partially funded with tax-free monies (i.e., a minority of the dues-paying members deducted their dues payments and the organization did not pay an entity-level tax on such amounts, which were used to fund electioneering).

²³¹ Treas. Reg. sec. 1.527-6(b)(5). It is not clear whether the same expenditures if incurred by a section 527 political organization would constitute "exempt function" expenditures. Treas. Reg. sec. 1.527-2(a)(3) provides that a political organization does not conduct "exempt function" activities when it sponsors "nonpartisan educational workshops which are not intended to influence" the election of candidates. See also 1993 IRS CPE Text, supra, at 450. Nevertheless, expenses of voter registration activities could be considered indirect "exempt function" expenses (regardless of intent) under Treas. Reg. sec. 1.527-2(c)(2), which provides that expenses for an "exempt function" activity include expenses "which are necessary to support the directly related activities of the political organization," such as overhead, record keeping, and fundraising expenses.

²³² Treas. Reg. secs. 1.527-2(c)(5)(vi) and 1.527-6(b)(4). This exception for providing technical advice applies only to expenditures which are directly related to appearances before a legislative body to influence the appointment or confirmation or a nominee for public office. Apparently, this exception is similar to, but more limited than, the "furnishing technical advice or assistance" exception relating to legislative lobbying under sections 4911(2)(B) and 4945(e)(2), which applies to furnishing technical advice to a governmental body by providing an oral or written presentation. See Treas. Reg. secs. 56.4911-2(c)(3) and 53.4945-2(d)(2); 1993 IRS CPE Text, supra, at 482 n.11.

provided in Treas. Reg. sec. 1.527-6(b)(3).²³³

Use of separate segregated funds

Subsection 527(f)(3) provides that certain separate segregated funds, such as a political action committee (“PAC”), established by tax-exempt organizations will be treated as separate organizations. In essence, the separate segregated fund is taxed as if it were a separate political organization.²³⁴ An organization may establish a separate segregated fund only if this is consistent with its tax-exempt status.²³⁵ Thus, a section 501(c)(3) charity may not establish a PAC or other separate fund to engage in political campaign intervention, but may establish a separate fund to attempt to influence nominations to non-elected public offices (provided that this activity and other lobbying activities are not substantial).

The separate-fund rule provided by subsection 527(f)(3) does not reduce the section 527(f) tax to a mere formality which can be avoided by an organization described in section 501(c) simply establishing a separate fund and transferring monies at any time (perhaps including investment income) to that separate fund. The section 527(f) tax applies if an organization either directly expends amounts for an exempt function activity or does so indirectly "through another organization."²³⁶ However, consistent with the legislative history to section 527,²³⁷ transfers of political contributions by a section 501(c) organization to a separate segregated fund are not treated as “exempt function” expenditures by the transferor organization if the transfer is made “promptly and directly” (under procedures permitted by Federal or State campaign laws) after the contributions are received by the transferor organization from third-party contributors.²³⁸ In such cases, the section 501(c) organization is treated as a mere conduit for the transfer of political contributions from a third party to the separate segregated fund, and the subsequent expenditures

²³³ Treas. Reg. sec. 1.527-6(b)(3) has not yet been issued, however, and is therefore “reserved.”

²³⁴ In enacting section 527, Congress expected that, to avoid taxation on investment income not used for "exempt function" activities within the meaning of section 527, section 501(c) organizations would establish separate funds that would operate primarily as political organizations and directly receive and disburse funds for section 527 activities. See S. Rep. No. 93-1357, at 29 (1974).

²³⁵ Treas. reg. sec. 1.527-6(f).

²³⁶ Sec. 527(f)(1).

²³⁷ See Conf. Rpt. No. 93-1642, at 30 (1974).

²³⁸ See Treas. Reg. sec. 1.527-6(e).

of the separate segregated fund will not be attributed to the affiliated 501(c) organization.²³⁹

3. Limitations on charitable contributions under section 170

In general, the fact that a section 501(c)(3) charity engages in some lobbying activities, but only to the extent consistent with remaining exempt under that section, has no effect on the charitable contribution deductions of taxpayers making contributions to the charity. However, Treasury regulations provide that contributions to a charity that are specifically earmarked for lobbying are not allowable as charitable contribution deductions.²⁴⁰ In addition, section 170(f)(6) provides that no charitable contribution deduction is allowed for an out-of-pocket expenditure made by any person on behalf of a charity--other than a church--if the expenditure is made for the purpose of influencing legislation (within the meaning of section 501(c)(3)).

Furthermore, section 170 was amended by Congress in 1993 to prevent donors from using charities as a conduit to conduct legislative activities, the cost of which would not be deductible if conducted directly by the donor. No charitable contribution deduction is allowed for amounts contributed to a charity that conducts lobbying activities (as defined in section 162(e)(1)) if (1) the charity's lobbying activities regard matters of direct financial interest to the donor's trade or business, and (2) a principal purpose of the contribution is to avoid the general disallowance rule under section 162 that would apply if the contributor directly had conducted such lobbying activities.²⁴¹ This anti-abuse rule is designed to prevent taxpayers from evading

²³⁹ See PLR 9245001 (June 8, 1992) (quarterly transfer of political contributions to a separate segregated fund were made "promptly and directly" within the meaning of Treas. Reg. sec. 1.527-6(e)); GCM 39837 (May 22, 1990) (contributions designated for an affiliated PAC that were received and temporarily deposited in an interest bearing checking account by 501(c)(5) and 501(c)(6) organizations were transferred to the separate segregated fund "promptly and directly"); TAM 8628001 (Feb. 7, 1986) (labor organization did not earmark certain percentage of member's dues to be used for political purposes, but transfer of funds from general accounts into segregated accounts for state election purposes was a qualifying transfer for sec. 527 purposes). But see Alaska Public Service Employees Local 71 v. Commissioner, T.C. Memo. 1991-650 (1991) (transfer of monies by labor organization to separate political fund constituted political expenditure by labor organization itself because transfer was made from undesignated funds and no showing that transfer consisted solely of dues and not of investment income). See generally Cerny & Hill, supra, at 609-10.

²⁴⁰ Treas. Reg. sec. 1.170A-1(h)(6) provides: "No deduction shall be allowed under section 170 for expenditures for lobbying purposes, the promotion or defeat of legislation, etc. See also the regulations under sections 162 and 4945." See also Rev. Rul. 80-275, 1980-2 C.B. 69. Because section 501(c)(3) organizations cannot engage in political campaign intervention, a contribution earmarked for such political campaign purposes likewise would not be allowable as a charitable deduction.

²⁴¹ Sec. 170(f)(9).

the rules under section 162(e)--which do not contain an exception for nonpartisan analysis--by simply contributing funds to a charity that, in turn, conducts nonpartisan analysis of legislative proposals affecting the contributor's trade or business.²⁴²

²⁴² Prior to the 1993 Act amendments, Code section 162(e) disallowed deductions for amounts paid for political campaign activities or grass roots lobbying. However, a deduction was allowed for all ordinary and necessary business expenses incurred in direct connection with lobbying legislative bodies with respect to legislation of direct interest to the taxpayer. Prior to 1993, a deduction also was permitted for business expenses incurred in direct connection with the communication of information between a taxpayer and an organization of which he is a member (and for dues payments) with respect to legislation of direct interest to the taxpayer and organization. In 1993, Congress repealed the deduction previously allowed under section 162 for certain "direct lobbying" expenses, except that expenses for direct lobbying before local councils continues to be deductible if related to legislation of direct interest to the taxpayer. See sec. 162(e)(2). At the Federal level, however, the section 162(e) nondeductibility rule applies not only to direct and grass roots lobbying to influence legislation, but also to contacting certain high-ranking Federal executive branch officials in an attempt to influence their official actions or positions. See sec. 162(e)(1)(D).